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IN THE

Supreme Court of the United States

CAREY D. EBERT, AS TRUSTEE IN BANKRUPTCY FOR GRAVITY, INC., AND MARK H. DICKSON,
Petitioners,

v.

MICROSOFT CORPORATION, COMPAQ COMPUTER CORPORATION, DELL COMPUTER CORPORATION, AND PB ELECTRONICS, INC. (F/K/A PACKARD BELL NEC, INC.),
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Fourth Circuit

PETITION FOR A WRIT OF CERTIORARI

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10 pp

QUESTIONS PRESENTED

1. Whether distributors who entered into anticompetitive agreements with a manufacturer, having knowledge that other competing distributors were entering similar anticompetitive agreements with that same manufacturer, thereby joined a single, "hub-and-spoke" antitrust conspiracy.

2. Whether the fundamental notice pleading standards just reaffirmed by this Court in *Swierkiewicz v. Sorema N.A.*, 122 S. Ct. 992 (2002), permit a court to disregard the relevant markets alleged and require a plaintiff to plead specific facts supporting anticompetitive effect.

3. Whether the *indirect* purchaser rule of *Illinois Brick Co. v. Illinois*, 431 U.S. 720 (1977), which bars antitrust damage suits against a manufacturer by customers of that manufacturer's distributors, should apply where the manufacturer and its distributors unlawfully conspired to restrain competition, thus making the plaintiff-customer a *direct* purchaser from the conspiracy.

CORPORATE DISCLOSURE STATEMENT

Pursuant to Rule 29.6 of the Rules of this Court, petitioner Carey D. Ebert, as Trustee in Bankruptcy for Gravity, Inc., states the following:

Gravity, Inc. is neither a publicly owned corporation nor a subsidiary or affiliate of a publicly owned corporation.

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PETITION FOR A WRIT OF CERTIORARI

Carey D. Ebert, as Trustee in Bankruptcy for Gravity, Inc., and Mark H. Dickson (collectively "Gravity") respectfully petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the Fourth Circuit in this case.

The divided panel's affirmance of the district court's dismissal of Gravity's class action complaints presents three inter-related issues of exceptional importance to the sound administration of the antitrust laws, which this Court should resolve. The panel majority's erroneous resolution of each of these issues affects millions of consumers nationwide who purchased software made by defendant Microsoft Corporation that was distributed with a computer sold by one of the three defendant computer makers – Compaq Computer Corporation ("Compaq"), Dell Computer Corporation ("Dell"), and PB Electronics, Inc. ("PB") (original equipment manufacturers, or

"OEMs"). If not corrected, these errors also promise to infect many subsequent antitrust cases.

First, the divided Fourth Circuit panel parted ways with the Sixth and Eighth Circuits in holding that allegations of a single conspiracy between a "hub" (Microsoft) and several "spokes" (the OEM defendants) cannot state a claim under Sherman Act §§ 1 and 2. That holding conflicts, moreover, with several decisions of this Court establishing that those who enter a conspiracy with a common "hub," having knowledge that other "spokes" are likewise involved with that hub, are jointly liable in a single conspiracy.

Second, in disregarding the relevant software markets in this case and requiring the complaint to state specific facts supporting an allegation of market power in the computer market, the panel majority disregarded fundamental notice pleading standards just reaffirmed by this Court in *Swierkiewicz v. Sorema N.A.*, 122 S. Ct. 992 (2002). In any case, Gravity did allege facts demonstrating actual anticompetitive effects in the relevant software markets.

Third, the panel majority parted ways with unanimous precedent from three circuits holding the indirect purchaser rule of *Illinois Brick Co. v. Illinois*, 431 U.S. 720 (1977), inapplicable to allegations of a vertical conspiracy. In doing so, the panel majority fundamentally undermined the deterrence rationale underpinning *Illinois Brick*, where this Court found that direct purchasers from a manufacturer would generally have the most incentive to sue that manufacturer for an antitrust violation. That reasoning fails once the so-called direct purchaser joins with the manufacturer in an antitrust conspiracy, and the panel majority erred in not holding that the consumer plaintiffs here were direct purchasers *from the conspiracy*.

The cumulative effect of these three decisions is to deal a severe blow both to consumers' rights to recover for damages sustained in software markets and to incentives

for upstart software makers to innovate in competition with Microsoft. As Judge Gregory's dissent concluded:

> The most unfortunate aspect of this case is that, to the extent Gravity's claims have merit, consumers will be left uncompensated. Even more, raising the procedural bar for consumers' claims may further stifle technological innovation. By giving comfort to those entrenched interests that seek to protect the status quo, today's decision increases the likelihood of future anticompetitive conduct. To those who would introduce disruptive technologies, this ruling creates a strong disincentive to innovate. Without innovation, we all lose.

Pet. App. 45a.

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-45a) is reported at 309 F.3d 193. The opinions of the district court (Pet. App. 46a-56a, 57a-64a) are reported at 127 F. Supp. 2d 728 and 168 F. Supp. 2d 541, respectively.

JURISDICTION

The court of appeals entered its judgment on October 28, 2002, and denied a petition for rehearing and rehearing *en banc* on December 19, 2002. Pet. App. 65a. This Court's jurisdiction is invoked under 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS INVOLVED

Sections 1 and 2 of the Sherman Act, 15 U.S.C. §§ 1 and 2, are reproduced at Pet. App. 66a.

STATEMENT

In the government's case against Microsoft, the unanimous, *en banc* D.C. Circuit held that Microsoft had violated the antitrust laws, *inter alia*, through a series of unlawful, exclusionary licensing agreements with computer makers that protected Microsoft's "Windows" operating system monopoly from competition. *See United States v. Microsoft Corp.*, 253 F.3d 34 (D.C. Cir.) (*per curiam*) ("*Microsoft*"), *cert. denied*, 122 S. Ct. 350 (2001). The point of these agreements, as the D.C. Circuit recognized,

was that Microsoft could not effectively exclude rival operating systems on its own, so it either "hired" for monetary or in-kind compensation or coerced the largest OEMs to assist its anticompetitive schemes.

Gravity brought this consumer class action challenging antitrust conspiracies between Microsoft and the three largest (and most culpable) OEMs – Compaq, Dell, and PB – to limit competition and to maintain Microsoft's monopolies in operating system software, word processing software, and spreadsheet software. These combinations, which violated Sherman Act §§ 1 and 2, are demonstrated by a series of agreements between Microsoft and the OEMs. Gravity has sought to represent classes of the customers of the OEM defendants. Microsoft, an undisputed monopolist in each of the relevant software markets, joined together with the OEM defendants to fend off potential threats to its monopolies from competing software and new computing platforms that could completely replace Microsoft software. These conspiracies have denied customers of the named OEMs competitive software prices and the choice of competitive software products.

The D.C. Circuit unanimously held that many of the exclusionary agreements on which Gravity relies were "anticompetitive" and "unredeemed by any legitimate justification" within the standards of § 1, and thus supported a finding that Microsoft violated § 2 by entering them with OEMs. *Microsoft*, 253 F.3d at 61-64. The court focused on Microsoft's end of these unlawful licensing agreements because the government's central claim was for § 2 monopoly maintenance against Microsoft alone. But the court's conclusion that these agreements themselves constituted stand-alone § 1 violations provides strong support for Gravity's allegations that they violated § 1, not just for Microsoft, but also for the OEM defendants – whose help Microsoft needed to (and did) obtain in order to maintain its monopolies.

Gravity filed this case nine months before the district court issued its findings of fact in the government's case,

see United States v. Microsoft Corp., 84 F. Supp. 2d 9 (D.D.C. 1999) ("*Microsoft Findings of Fact*"), *aff'd in relevant part and rev'd in part, Microsoft*, 253 F.3d 34, and 10 months or more before numerous other federal and state cases based on those findings were begun. The government's case sought only injunctive relief against Microsoft – but did not seek the damages necessary to compensate millions of injured consumers.

The D.C. Circuit noted that such injunctive "[c]onduct remedies may be unavailing in [computer software industry] cases, because innovation to a large degree has already rendered the anticompetitive conduct obsolete (although by no means harmless). And broader structural remedies (such as a break-up of Microsoft) present their own set of problems, including how a court goes about *restoring* competition to a dramatically changed, and constantly changing, marketplace." *Microsoft*, 253 F.3d at 49. Accordingly, "the threat of private damage actions will remain to deter those firms inclined to test the limits of the law" and to redress the past harm done to consumers. *Id.*

Thus, private damage actions such as Gravity's "are an important element of the Nation's antitrust enforcement effort: Congress created the treble-damages remedy . . . precisely for the purpose of encouraging *private* challenges to antitrust violations. These private suits provide a significant supplement to the limited resources available to the Department of Justice for enforcing the antitrust laws and deterring violations." *American Soc'y of Mech. Eng'rs, Inc. v. Hydrolevel Corp.*, 456 U.S. 556, 572 n.10 (1982) (internal quotation marks omitted).

1. Microsoft has maintained a monopoly in the operating system software market for Intel-compatible personal computers ("PCs") through its ubiquitous Windows software, which has gained more than 95% market share. *See Microsoft*, 253 F.3d at 51-58. Operating systems function as platforms for software applications such as word processing and spreadsheet programs. "They do this by

'exposing' – *i.e.*, making available to software developers – routines or protocols that perform certain widely-used functions . . . known as Application Programming Interfaces, or 'APIs.' " *Id.* at 53. "For example, Windows contains an API that enables users to draw a box on the screen," which software developers can use rather than duplicating it in their own code. *Id.*

Microsoft's monopoly power reflects that the market for software is characterized by substantial economies of scale: once software is written, copies can be produced very cheaply. There are also significant network effects, whereby one product or standard tends toward dominance because consumer benefits increase as others adopt and use it. For example, benefits to telephone users increase with the number of other users with whom they can communicate on the telephone network. Likewise, PC users generally prefer operating software for which there are a high number, variety, and quality of software applications; application developers, in turn, make their programs compatible with the most commonly used operating software in order to appeal to the greatest number of potential customers. *See id.* at 49, 55. Microsoft thus enjoys the protection of a significant "applications barrier to entry" that restrains its competition. *Id.* at 55.[1]

Microsoft saw the need, however, to enlist its largest OEM partners to help preserve this barrier against challenges from competing alternative platforms. In particular, "middleware" platforms allow software developers to write programs (such as word processors) that interface with the middleware rather than the underlying operating system. A middleware product written for Windows could thus "take over some or all of Windows's valuable platform functions – that is, developers might begin to rely upon APIs exposed by the middleware for basic routines rather than relying upon the API set included in

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[1] Microsoft also maintains monopoly market shares of more than 80% in the word processing and spreadsheet software markets, which it attained in part due to its operating system monopoly.

Windows." *Id.* at 53. Microsoft identified internet browsers such as Netscape Navigator (used in conjunction with a programming language called Java) as serious middleware threats to its operating software monopoly. *See id.* at 53, 74.[2]

Because internet browsers and Java can overcome incompatibility among different operating systems, they threaten to eliminate the key applications barrier to entry protecting Microsoft's operating software market share:

> If a consumer could have access to the applications he desired – regardless of the operating system he uses – simply by installing a particular browser on his computer, then he would no longer feel compelled to select Windows in order to have access to those applications; he could select an operating system other than Windows based solely upon its quality and price. In other words, the market for operating systems would be competitive.

Id. at 60. Microsoft therefore sought to establish the predominance of its own internet browser, Internet Explorer, by "prevent[ing] OEMs from promoting both rival browsers and IAPs [Internet Access Providers] that might use rivals' browsers." *Id.* at 62.

2. These same threats to Microsoft's monopolies have also threatened the OEM defendants – Compaq, Dell, and PB. Microsoft distributes its operating software primarily through installation on PCs sold by computer makers. In 1997, 87.6% of all copies of Microsoft's Windows operating software were installed by PC manufacturers. *See* C.A. App. 109-10, 473-74. During the relevant period, Compaq, Dell, and PB were the three largest PC makers

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[2] As Gravity alleged, competing middleware platforms also threaten Microsoft's monopolies in word processing and spreadsheet software, as these platforms affect Microsoft's ability to exclude competition by retaining control over the interface between applications software and the operating system. *See* C.A. App. 137, 500-01.

and were among the largest distributors of Microsoft's products. *See id.* at 114, 478.

Anticompetitive Restrictions. Gravity alleged that Microsoft and the OEM defendants, to advance their common self-interest (as the manufacturer and its largest distributors), violated Sherman Act §§ 1 and 2 by entering conspiracies to exclude competition and to protect Microsoft's monopolies in the relevant software markets. As recounted by the panel majority, those agreements consisted of "(1) a prohibition against removing icons, folders, or Start menu entries from the Windows desktop; (2) a prohibition against modifying the initial Windows boot sequence; (3) the integration of Internet Explorer (IE), Microsoft's Internet browser software, and other application software with Microsoft's operating software; and (4) the inclusion of long-term distribution contracts, exclusive dealing distribution arrangements, and per-processor license fees." Pet. App. 3a.[3]

The D.C. Circuit specifically condemned the first two restrictions listed above in the government's case against Microsoft. Employing the rule of reason applicable here to Gravity's § 1 claim, the court held that they were "anticompetitive" and "unredeemed by any legitimate justification," and therefore supported a finding against Microsoft of exclusionary conduct in violation of § 2. *Microsoft*, 253 F.3d at 59, 61, 64. The court held that the "anticompetitive effect of the license restrictions is, as Microsoft itself recognizes, that OEMs are not able to promote rival browsers, which keeps developers focused upon the APIs in Windows." *Id.* at 62; *see also* Pet. App. 6a-7a.

Benefits Received. In exchange for agreeing to Microsoft's restrictive licensing provisions, the OEM defendants received various benefits, including monetary discounts

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[3] Gravity proposed two classes, one for United States purchasers of Microsoft operating software installed on a personal computer and sold by one of the OEM defendants, the other for Microsoft word processing and spreadsheet software purchased and sold in the same way. *See* Pet. App. 2a-3a.

on software, greater cooperation from Microsoft in product development, the ability to sell more computer hardware than they would have sold if the software markets were competitive, and assurance that they would not be undercut by rivals offering either comparable hardware with lower-priced software or comparable hardware without software. *See* Pet. App. 3a-4a; *see also Microsoft Findings of Fact*, 84 F. Supp. 2d at 27 (¶ 64) ("Among the five largest OEMs, Gateway and IBM, which in various ways have resisted Microsoft's efforts to enlist them in its efforts to preserve the applications barrier to entry, pay higher prices than Compaq, Dell, and Hewlett-Packard, which have pursued less contentious relationships with Microsoft."); *id.* at 42 (¶ 129) ("Compaq and a handful of other OEMs enjoyed" "early access to Windows source code").

3. Gravity filed this consumer class action in the United States District Court for the District of Columbia in February 1999, and filed its First Amended Complaint ("FAC") as of right in March 1999. C.A. App. 101-49. The Judicial Panel on Multidistrict Litigation transferred the case to the United States District Court for the District of Maryland, where it was coordinated with approximately 64 other antitrust actions against Microsoft. The other actions were consolidated into a single class action, while Gravity's case was kept separate because it was the only complaint alleging claims against OEMs as defendants. Pet. App. 4a.

In January 2001, the district court granted defendants' motions to dismiss the FAC.[4] The court held that Gravity's §§ 1 and 2 allegations of a single conspiracy failed because they established only "a 'spokes of the wheel' conspiracy with Microsoft at the hub but no rim discernible to the naked eye," *id.* at 54a, despite the fact that the complaint alleges that the OEM defendants entered their anticompetitive agreements with Microsoft having

[4] In actuality, an individual, non-class claim remained, but it was subsequently dismissed with prejudice by Gravity and is not relevant to this petition. *See* C.A. App. 643.

knowledge that other of their OEM competitors were doing the same in an interdependent fashion.[5]

Gravity then moved to file a Second Amended Complaint ("SAC"), alleging that Compaq and Dell each entered into separate, bilateral combinations by way of contracts and other actions in concert with Microsoft to restrain trade unreasonably and to maintain Microsoft's monopolies. *See id.* at 5a.[6] The district court denied that motion as futile because "the damages claimed by plaintiffs cannot be said to have been caused by any single section 1 conspiracy between Microsoft and either Compaq or Dell," *id.* at 60a – despite the fact that those combinations were each, at the very least, material causes of the damages of Compaq and Dell customers represented by the proposed classes. The district court also held that *Illinois Brick*'s indirect purchaser rule barred Gravity's damage claims, despite the fact that plaintiffs were direct purchasers from the conspiracy. *Id.* at 60a-64a.

4. A divided panel of the Fourth Circuit affirmed. *Id.* at 1a-45a. The majority first found Gravity's hub-and-spoke theory in the FAC precluded by *Kotteakos v. United States*, 328 U.S. 750 (1946). *See* Pet. App. 9a-11a. The dissent reasoned that Gravity had set out a viable theory "consistent with well-established interpretations of the Sherman Act." *Id.* at 34a.

The panel majority also affirmed dismissal of the SAC's alternative allegation of two bilateral conspiracies be-

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[5] The district court also held that the alleged § 1 conspiracy "coalesced" with the alleged § 2 conspiracy, and therefore would have to meet the more stringent § 2 standard of specific intent. Pet. App. 48a-49a; *see id.* at 8a. The court of appeals correctly reversed this holding, because "[a] § 1 violation 'is legally distinct from that under § 2 . . . though the two sections overlap in the sense that a monopoly under § 2 is a species of trade restraint under § 1.'" *Id.* (quoting *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150, 224 n.59 (1940)).

[6] Gravity did not allege a bilateral conspiracy between Microsoft and PB because neither class representative purchased computers and software directly from PB.

tween Microsoft and Compaq, and Microsoft and Dell. The decision held that Gravity had not demonstrated anticompetitive effect by alleging the OEMs' individual market shares in the *computer* market, *id.* at 11a-27a, despite the fact that Gravity's allegations concern only *software* markets. In a footnote, the panel added that this holding also applied to Gravity's allegations in the FAC of a single conspiracy. *Id.* at 11a n.13. The dissent, on the other hand, concluded that "there is no question that Gravity's pleadings are more than adequate" under this Court's recent pronouncement on notice pleading in *Swierkiewicz*. *Id.* at 35a; *see id.* at 35a-41a. Moreover, "[t]he OEMs' specific market power in the PC market is, at best, a subsidiary fact" because "Microsoft is an adjudicated monopolist, with clear market power in the relevant *software* markets, and the defendant OEMs are among the largest players in the PC hardware market." *Id.* at 39a (emphasis added). In the dissent's view, the majority was not free to "misunderstand[] Gravity's argument regarding market power." *Id.* at 38a.[7]

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[7] The panel majority correctly rejected defendants' claims that Gravity had failed under § 1 to describe "'a unity of purpose or a common design and understanding'" between the OEM defendants and Microsoft, holding that "Gravity has sufficiently alleged that Microsoft and the OEM Defendants pooled their resources, rights, or economic power." Pet. App. 12a (quoting *Monsanto Co. v. Spray-Rite Serv. Corp.*, 465 U.S. 752, 764 (1984)). The majority likewise rejected the claim that conspiring with Microsoft would have been against the OEM defendants' self-interest, in view of Gravity's § 1 allegations that they "received financial and other benefits in exchange for entering into the licensing agreements." *Id.* The majority further noted that "'the "combination or conspiracy" element of a section 1 violation is not negated by the fact that one or more of the co-conspirators acted unwillingly, reluctantly, or only in response to coercion.' . . . The co-conspirators need not share the same motive or goal; it is sufficient to allege that the co-conspirators 'acquiesc[ed] in an illegal scheme.'" *Id.* at 13a (quoting, in turn, *MCM Partners, Inc. v. Andrews-Bartlett & Assocs.*, 62 F.3d 967, 973 (7th Cir. 1995), and *United States v. Paramount Pictures, Inc.*, 334 U.S. 131, 161 (1948)).

Finally, the panel majority held that Gravity's damage claims[8] were precluded by the indirect purchaser rule of *Illinois Brick*. *Id.* at 27a-32a. The dissent reasoned that the majority had entirely misapplied this Court's deterrence rational from *Illinois Brick*, and accordingly would have followed the unanimous authority from three other circuits (including decisions by Judges Posner and Easterbrook) holding *Illinois Brick* simply inapplicable to vertical conspiracy claims. *Id.* at 41a-45a.

Gravity timely filed a petition for rehearing and rehearing en banc, which was denied on December 19, 2002. Pet. App. 65a.

REASONS FOR GRANTING THE PETITION

I. THE PANEL MAJORITY'S REJECTION OF GRAVITY'S HUB-AND-SPOKE THEORY CONFLICTS WITH DECISIONS FROM THE SIXTH AND EIGHTH CIRCUITS AND THIS COURT

Gravity's FAC alleged a single hub-and-spoke conspiracy with Microsoft at the hub and the three OEM defendants as spokes on the rim. Each OEM defendant entered a separate vertical agreement with Microsoft to harm competition, and each was aware that it was part of a larger scheme including other OEMs. The panel majority disregarded fundamental principles of antitrust conspiracy law set out by other circuits and this Court in holding that the OEM defendants' alleged knowledge that they were part of a broader anticompetitive scheme was insufficient to link them, as a matter of law, in a single conspiracy. There is no legal requirement that the OEMs along the rim of the conspiracy actually met or expressly agreed with one another.

As explained by the Sixth and Eighth Circuits, to establish a hub-and-spoke antitrust conspiracy, the plaintiff must show:

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[8] "*Illinois Brick*'s indirect purchaser rule, when applicable, bars only compensatory damages relief and does not apply to injunctive relief." Pet. App. 28a n.24.

> (1) that there is an overall-unlawful plan or "common design" in existence;
>
> (2) that *knowledge that others must be involved* is inferable to each member because of his knowledge of the unlawful nature of the subject of the conspiracy[,] but knowledge on the part of each member of the exact scope of the operation or the number of people involved is not required; and
>
> (3) there must be a showing of each alleged member's participation.

Elder-Beerman Stores Corp. v. Federated Dep't Stores, Inc., 459 F.2d 138, 146 (6th Cir. 1972) (emphasis added and deleted); *Impro Prods., Inc. v. Herrick*, 715 F.2d 1267, 1279 (8th Cir. 1983) (quoting *Elder-Beerman*).

The panel majority flatly rejected the Sixth and Eighth Circuits' standard, erroneously concluding that "[n]othing in the Supreme Court's holding in *Kotteakos* . . . suggests that such a proposition is correct or permissible." Pet. App. 11a. "[A] wheel without a rim is not a single conspiracy." *Id.* The panel majority defined "[a] rimless wheel conspiracy [as] one in which various defendants enter into separate agreements with a common defendant, but where the defendants have *no connection with one another*, other than the common defendant's involvement in each transaction." *Id.* at 9a (emphasis added).

But the court's convenient shorthand, "rimless wheel," is a conclusion masquerading as reasoning. Gravity's allegation is *not* that the OEMs had "no connection with one another." To the contrary: "The critical difference between the test Gravity urges, and the test *Kotteakos* rejected lies in the requirement 'that knowledge that others must be involved is inferable to each member because of his knowledge *of the unlawful nature of the subject of the conspiracy*.'" Dissent, *id.* at 34a (quoting *Impro*, 715 F.2d at 1279). That knowledge is what connects the spokes of the rim, whether or not the OEM defendants ever met or expressly agreed with each other. "Gravity has alleged that the nature of the conspiracy, by design

and by necessity, was broader than any one agreement between Microsoft and an OEM, and that knowledge of that interdependent design was inferable to each member of the conspiracy." *Id.*

These allegations of a single conspiracy fall comfortably within settled principles of conspirator liability that the panel majority inexplicably rejected outright. In straining to reject Gravity's claims, the majority reached a decision that squarely conflicts with this Court's holding in *Blumenthal v. United States*, 332 U.S. 539 (1947), which distinguished *Kotteakos* (one year after deciding it). In *Blumenthal*, the Court held that three distributors – who did not even know each other – joined a *single* conspiracy with the seller at the hub of the conspiracy:

> [T]he salesmen knew or must have known that others unknown to them were sharing in so large a project; and it hardly can be sufficient to relieve them that they did not know, when they joined the scheme, who those people were or exactly the parts they were playing in carrying out the common design and object of all. By their separate agreements, if such they were, they became parties to the larger common plan, *joined together by their knowledge of its essential features and broad scope*, though not of its exact limits, and by their common single goal.

Id. at 558 (emphasis added).

Blumenthal is thus indistinguishable from Gravity's allegation that the OEM defendants knew or should have known that others were involved in the conspiracy orchestrated by Microsoft, and thereby joined it. The majority fundamentally erred in rejecting the principle that Microsoft's co-conspirators are liable if they assented with knowledge they were joining a broader scheme and thus formed a single conspiracy including other OEMs. "It takes no stretch of logic to infer that the OEMs knew that Microsoft's plans contemplated the cooperation of other OEMs. It is the agreement to participate in this common

plan that formed a single conspiracy." Dissent, Pet. App. 35a.[9]

The panel majority's decision likewise conflicts irreconcilably with this Court's controlling precedent specifically applying the same conspiracy principles in the antitrust context. As the Court has long held, there need not be any express agreement between every conspirator in order for a single antitrust conspiracy to be formed. *See Interstate Circuit, Inc. v. United States*, 306 U.S. 208, 227 (1939) ("Acceptance by competitors, without previous agreement, of an invitation to participate in a plan, the necessary consequence of which, if carried out, is restraint of interstate commerce, is sufficient to establish an unlawful conspiracy under the Sherman Act."); *United States v. Masonite Corp.*, 316 U.S. 265, 275 (1942) ("Here, as in Interstate Circuit, . . . [i]t was enough that, knowing that concerted action was contemplated and invited, the distributors gave their adherence to the scheme and participated in it.") (internal quotation marks omitted).

Gravity's reliance on these cases – which the decision below does not distinguish or even cite – firmly grounded its claims in uncontroversial Sherman Act principles, and the decision below fundamentally disregarded these controlling precedents. *See* Dissent, Pet. App. 35a. The Court should grant review to resolve the conflicts that the panel majority's gross misapplication of antitrust conspiracy law created with regard to a hub-and-spoke conspiracy. Until now, "[t]he law has been clear that there need

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[9] It is no answer to say, as defendants might, that the court of appeals' error was due to the fact that *Blumenthal* was not cited by any of the parties in the briefs filed before the panel majority decided this appeal. The same absence of citation applies to *Kotteakos*, for the defendants had never relied on it, and correctly so; the panel majority chose to commit that serious error on its own. In its petition for rehearing and rehearing en banc, Gravity pointed out the panel majority's mistake in detail, along with the irreconcilable conflict that it created with *Blumenthal*. In response, however, the panel majority stuck with its original flawed decision and denied rehearing by a vote of 2-1.

not be an express agreement between every conspirator in order for a single conspiracy to be formed." *Id.* at 34a.

II. THE PANEL MAJORITY'S DECISION CONTRAVENES THIS COURT'S RECENT NOTICE PLEADING PRONOUNCEMENT

The panel majority erroneously rejected Gravity's bilateral conspiracy claims in the SAC because it had not alleged "facts demonstrating Compaq's or Dell's power or share in the PC market," which the majority considered necessary to show an anticompetitive effect in the relevant software markets. Pet. App. 23a. It added that this holding also applied to Gravity's allegations of a single, hub-and-spoke conspiracy in the FAC. *See id.* at 11a n.13. As the dissent explained, "[t]he majority's pleading standard conflicts with the Supreme Court's recent pronouncement on federal pleading requirements." *Id.* at 36a. "[U]nder a notice pleading system, it is not appropriate to require a plaintiff to plead facts establishing a prima facie case." *Swierkiewicz*, 122 S. Ct. at 997.

In *Swierkiewicz*, this Court reaffirmed that Federal Rule of Civil Procedure 8 requires only that the complaint "'give the defendant fair notice of what the plaintiff's claim is and the grounds upon which it rests.'" *Id.* at 998 (quoting *Conley v. Gibson*, 355 U.S. 41, 47 (1957)). "Given the Federal Rules' simplified standard for pleading, a court may dismiss a complaint only if it is clear that no relief could be granted under any set of facts that could be proved consistent with the allegations." *Id.* (internal quotation marks and alteration omitted).

The majority first erred by failing to credit the complaints' reliance on Microsoft's and its co-conspirators' combined market power in the relevant *software* markets. Instead, the majority required Gravity to dismember the conspiracy and plead the OEM defendants' power alone in the PC market. As the dissent correctly understood, "the relevant market is software, and the relevant entity is the conspiracy (either a bilateral or single conspiracy)." Pet. App. 38a. "The OEMs' specific market power in the PC

market is, at best, a subsidiary fact" because "Microsoft is an adjudicated monopolist, with clear market power in the relevant software markets, and the defendant OEMs are among the largest players in the PC hardware market. There is simply no conceivable argument from which one could conclude, based solely on a failure to plead market share, that the defendants are not on notice of the claims against them and the grounds on which they rest." *Id.* at 39a; *see also id.* at 38a ("The Court finds Gravity's allegations of market power deficient, but only because it misunderstands Gravity's argument regarding market power.").

Having erroneously interjected the PC market into this case, the panel majority further disregarded *Swierkiewicz* by demanding evidentiary (rather than notice) pleading of the OEM defendants' PC market power in order to show that they alone could cause anticompetitive effects in the relevant software markets. In *Swierkiewicz*, both lower courts had held that a plaintiff asserting discrimination claims must plead a prima facie case under the familiar *McDonnell Douglas*[10] framework in order to survive a motion to dismiss. But the Court unanimously rejected that proposition because "[t]he prima facie case under *McDonnell Douglas* . . . is an evidentiary standard, not a pleading requirement." 122 S. Ct. at 997.

So too with the *evidentiary* rule of reason standard applicable to Gravity's claims. "While anticompetitive effect is often proven through analysis of the relevant market definition and market power, it can also be proven through *actual* anticompetitive effects." Dissent, Pet. App. 37a; *see FTC v. Indiana Fed'n of Dentists*, 476 U.S. 447, 460-61 (1986) ("Since the purpose of the inquiries into market definition and market power is to determine whether an arrangement has the potential for genuine adverse effects on competition, 'proof of actual detrimental effects, such as a reduction of output,' can obviate the

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[10] *See McDonnell Douglas Corp. v. Green*, 411 U.S. 792 (1973).

need for an inquiry into market power, which is but a 'surrogate for detrimental effects.'") (quoting VII Phillip Areeda, *Antitrust Law* § 1511, at 429 (1986)).

Swierkiewicz makes crystal clear that the majority's pleading requirement is an evidentiary standard relying on circumstantial evidence of market power. Plaintiffs need not, however, plead a circumstantial case, because "discovery might uncover such direct evidence." 122 S. Ct. at 997 ("It . . . seems incongruous to require a plaintiff, in order to survive a motion to dismiss, to plead more facts than he may ultimately need to prove to succeed on the merits if direct evidence of discrimination is discovered.").

In any case, Gravity has alleged facts demonstrating an actual anticompetitive effect on the relevant software markets at issue here. As the majority noted, Gravity alleged that Microsoft willingly parted with some of its monopoly profits by giving Compaq, Dell, and PB discounts and other substantial benefits. *See* Pet. App. 3a-4a. That it was willing to pay such a premium strongly indicates that, in Microsoft's view, each OEM defendant significantly contributed to the success of the exclusionary schemes that injured consumers who bought from these OEMs. *See In re Brand Name Prescription Drugs Antitrust Litig.*, 123 F.3d 599, 615 (7th Cir. 1997) ("[F]irms may transform monopoly profits into costs in their efforts to engross a larger share of them."); *Microsoft Findings of Fact*, 84 F. Supp. 2d at 27 (¶ 64) ("[Microsoft] charges different OEMs different prices for Windows, depending on the degree to which the individual OEMs comply with Microsoft's wishes.").

This material fact plainly suggests that the alleged agreements between Microsoft and the OEM defendants, whether viewed together or separately, had actual anticompetitive effects on software markets. As this Court has held, all plaintiffs have to show is that the alleged single or bilateral *conspiracies* – not the individual actors – were a material contributing cause of consumer harm. And that contributing cause need not be the sole cause:

> [Plaintiff's] burden of proving the fact of damage under § 4 of the Clayton Act [15 U.S.C. § 15] is satisfied by its proof of *some* damage flowing from the unlawful conspiracy; inquiry beyond this *minimum point* goes only to the amount and not the fact of damage. It is enough that the illegality is shown to be a material cause of the injury; a plaintiff need not exhaust all possible alternative sources of injury in fulfilling his burden of proving compensable injury under § 4.

Zenith Radio Corp. v. Hazeltine Research, Inc., 395 U.S. 100, 114 n.9 (1969) (emphasis added in part); *see also Allied Accessories & Auto Parts Co. v. General Motors Corp.*, 825 F.2d 971, 973 (6th Cir. 1987) (plaintiff need not show that defendants' conduct "was the *sole* cause of" plaintiff's damages). The panel majority was therefore wrong to require a showing that each OEM defendant alone "has forced, or is likely to be able to force, supra-competitive prices on consumers for undesirable software features." Pet. App. 18a.

Indeed, if plaintiffs were required to surmount the court's hurdle that Microsoft's agreement with each OEM defendant had the suppressive effects that plaintiffs allege, then much anticompetitive conduct would become untouchable. As in this case, Microsoft could conspire with a number of OEMs, yet none of those combinations would be actionable merely because the anticompetitive conduct – though necessary to stifle middleware – was not sufficient in and of itself to cause the entire consumer harm.

The Court should grant review to make clear that, under the notice pleading standard reaffirmed in *Swierkiewicz*, courts are not free to fashion their own relevant markets and impose evidentiary pleading standards concerning market power and anticompetitive effect. "A requirement of greater specificity for particular claims is a result that must be obtained by the process of amending the Federal Rules, and not by judicial interpretation."

Swierkiewicz, 122 S. Ct. at 999 (internal quotation marks omitted).

III. THE JUDGMENT BELOW CONFLICTS WITH PRECEDENT FROM THREE OTHER CIRCUITS HOLDING *ILLINOIS BRICK* INAPPLICABLE TO CONSPIRACY CLAIMS AND MISCONSTRUES AND UNDERMINES THIS COURT'S DECISION IN *ILLINOIS BRICK*

In *Illinois Brick*, the Court ruled that purchasers of goods generally may not bring federal antitrust damage claims against a manufacturer where they bought the manufacturer's goods indirectly through an intermediary. *See* 431 U.S. at 736-48 (interpreting § 4 of the Clayton Act, 15 U.S.C. § 15). The defendants in *Illinois Brick* sold bricks to masonry contractors at allegedly inflated prices, and the contractors in turn "passed on" some or all of those overcharges to the plaintiffs who purchased their constructed buildings. *See id.* at 726. The Court's holding that the plaintiff indirect purchasers could not sue was a logical corollary to *Hanover Shoe, Inc. v. United Shoe Machinery Corp.*, 392 U.S. 481 (1968), which held that a defendant cannot escape antitrust liability by showing that the plaintiff (direct purchaser) had passed on the anticompetitive overcharge to its customers (indirect purchasers) and was therefore not harmed.

In *Illinois Brick* (as in *Hanover Shoe*), there was no allegation that the direct purchasers were co-conspirators with the manufacturer. On the necessarily implicit assumption that the direct purchaser intermediaries were innocent of wrongdoing, the Court reasoned that, even though indirect purchasers may be injured, two reasons counseled against permitting them to sue the upstream seller. First, there would be a danger of multiple, "overlapping recoveries" against the original seller by both direct and indirect purchasers. *Illinois Brick*, 431 U.S. at 730-31. Second, the Court was concerned about "evidentiary complexities and uncertainties" (*id.* at 732) in determining the amount of any overcharge passed through

by the intermediary to the indirect purchaser. *See id.* at 728-33, 740-46.

The Court made crystal clear, however, that it only established these two factors in order to provide maximum deterrence of antitrust violations. Thus, in the context of that non-conspiracy case, "the longstanding policy of encouraging vigorous private enforcement of the antitrust laws" called for a rule "under which direct purchasers are not only spared the burden of litigating the intricacies of pass-on but also are permitted to recover the full amount of the overcharge." *Id.* at 745-46. "[T]he legislative purpose in creating a group of 'private attorneys general' to enforce the antitrust laws . . . is better served by holding direct purchasers to be injured to the full extent of the overcharge paid by them than by attempting to apportion the overcharge among all that may have absorbed a part of it." *Id.* at 746.

A. The Judgment Below Conflicts with Precedent from Three Circuits

The Court should grant review to clarify that the indirect purchaser rule of *Illinois Brick* does not apply to allegations of a conspiracy. Here, Gravity was the *direct* purchaser from the conspiracy, and the *in*direct purchaser rule is simply inapplicable. The Seventh, Ninth, and Eleventh Circuits have each held that *Illinois Brick* does not preclude claims against vertical co-conspirators (and four other circuits have suggested the same). "The first buyer from a conspirator is the right party to sue." *Paper Sys., Inc. v. Nippon Paper Indus Co.*, 281 F.3d 629, 631 (7th Cir. 2002) (Easterbrook, J.); *see also Lowell v. American Cyanamid Co.*, 177 F.3d 1228, 1232 (11th Cir. 1999) ("*Illinois Brick* does not apply to a single vertical conspiracy where the plaintiff has purchased directly from a conspiring party in the chain of distribution."); *Brand Name Prescription Drugs*, 123 F.3d at 604 ("[A]ny indirect-purchaser defense would go by the board, since the [plaintiffs] would then be direct purchasers from the conspirators.") (Posner, C.J.); *Arizona v. Shamrock Foods Co.*, 729

F.2d 1208, 1212-14 (9th Cir. 1984); *Fontana Aviation, Inc. v. Cessna Aircraft Co.*, 617 F.2d 478, 481 (7th Cir. 1980).[11]

The panel majority purported to distinguish these cases on the ground that their reasoning should be limited to price-fixing. *See* Pet. App. 30a-31a. But not one of those decisions limited its holding to a price-fixing conspiracy. Judge Easterbrook has explained broadly that "[t]he right to sue middlemen that joined the conspiracy is sometimes referred to as a co-conspirator 'exception' to *Illinois Brick*, but it would be better to recognize that *Hanover Shoe* and *Illinois Brick* allocate to the first non-conspirator in the distribution chain the right to collect 100% of the damages." *Paper Sys.*, 281 F.3d at 632. And a damage calculation need not be mechanically based on an agreement to set a specific price: "[If] the amount of the overcharge . . . cannot be established in any other way (for example, by the conspirators' own agreement) then it is necessary to determine the elasticities of supply and demand. But this prospect is present in every cartel case; it is not occasioned solely by the presence of intermediaries." *Id.* at 633. And Judge Posner has likewise held that "any indirect-purchaser defense would go by the board, since the [plaintiffs] would then be direct purchasers from the conspirators." *Brand Name Prescription Drugs*, 123 F.3d at 604. Indeed, *Fontana* held *Illinois Brick* inapplicable to a multifaceted conspiracy that included a combination of antitrust violations not limited to pricing. *See* 617 F.2d at 481. That is not surprising. In view of the deterrence rationale on which the indirect purchaser rule is grounded, the majority's price-fixing distinction makes no sense.

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[11] *Cf. Campos v. Ticketmaster Corp.*, 140 F.3d 1166, 1171 (8th Cir. 1998) (noting exception but finding no conspiracy allegation); *McCarthy v. Recordex Serv., Inc.*, 80 F.3d 842, 855 (3d Cir. 1996) (noting exception but declining to apply it because the upstream suppliers were not joined as defendants); *In re Beef Indus. Antitrust Litig.*, 600 F.2d 1148, 1163 (5th Cir. 1979) (same); *Jewish Hosp. Ass'n v. Stewart Mech. Enters., Inc.*, 628 F.2d 971, 977 (6th Cir. 1980) (noting exception but declining to apply it because vertical conspiracy allegations failed).

B. The Judgment Below Undermines the Deterrence Value on Which *Illinois Brick* Is Grounded

1. It is critical to understand that this Court grounded its decisions in *Illinois Brick* and *Hanover Shoe* on the understanding that the indirect purchaser rule would provide maximum deterrence and that the multiple-recovery and price-tracing concerns function only to serve this overarching purpose. The panel majority conceded as much in noting this Court's observation that indirect purchasers normally "'would have only a tiny stake' in enforcing the anti-trust law." Pet. App. 28a (quoting *Hanover Shoe*, 392 U.S. at 494). "In consequence," this Court explained in *Hanover Shoe*, "those who violate the antitrust laws by price fixing or monopolizing would retain the fruits of their illegality because no one was available who would bring suit against them." 392 U.S. at 494. In *Illinois Brick*, the Court likewise concluded that "the long-standing policy of encouraging vigorous private enforcement of the antitrust laws . . . supports our adherence to the *Hanover Shoe* rule, under which direct purchasers are not only spared the burden of litigating the intricacies of pass-on but also are permitted to recover the full amount of the overcharge." 431 U.S. at 745-46 (citation omitted). As the Court later confirmed, "*Illinois Brick* was concerned that requiring direct and indirect purchasers to apportion the recovery . . . would result in no one plaintiff having a sufficient incentive to sue." *California v. ARC Am. Corp.*, 490 U.S. 93, 104 (1989); *see also Paper Sys.*, 281 F.3d at 633 ("It is better, the Court held in both *Illinois Brick* and [*Kansas v. UtiliCorp United, Inc.*, 497 U.S. 199 (1990)], to avoid these complications and concentrate damages in the hands of the initial purchasers so as to maximize deterrence.").

This fundamental deterrence rationale for the indirect purchaser bar obviously fails once the intermediary "direct" purchaser becomes party to an antitrust violation. The co-conspiring intermediary has far less, and perhaps

no, incentive to sue its co-conspirator. As Professor Hovenkamp recently noted:

> The principal direct purchasers of the Windows operating system are [OEMs]. They have a complex, ongoing relationship with Microsoft and are also among the *biggest beneficiaries* of many of its practices. Because Microsoft continually issues new versions of Windows and withdraws support for older ones, computer users must frequently upgrade computers long before their operating life is over, even though many users have little need for the greater speed and sophistication of new machines. Because most end users cannot obtain damages and OEMs lack the proper incentives to sue, it is likely that few people will recover damages from Microsoft.

Herbert Hovenkamp, Book Review, *The Rationalization of Antitrust*, 116 Harv. L. Rev. 917, 941-42 (2003) (emphasis added).

Once these "biggest beneficiaries" of the exclusionary scheme become co-conspirators with Microsoft, it is fatuous to suggest that they are the best positioned to effect "the legislative purpose in creating a group of 'private attorneys general' to enforce the antitrust laws under [Clayton Act] § 4." *Illinois Brick*, 431 U.S. at 746 (internal quotation marks omitted). Neither *Illinois Brick* nor *Hanover Shoe* involved an alleged conspiracy between the manufacturer and its distributor, and the panel majority's decision below obliterates the critical deterrence goal underpinning those cases. As the dissent cogently recognized, denying co-conspirators the protection of *Illinois Brick* "maximizes deterrence by giving the right to sue to the plaintiff with the most incentive to sue." Pet. App. 43a.[12]

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[12] The panel majority noted that *Illinois Brick* "expressly contemplated two exceptions to the indirect purchaser rule: (1) where the indirect purchaser acquired goods through a preexisting cost-plus contract and (2) 'where the direct purchaser is owned or controlled by its customer.'" Pet. App. 29a (quoting *Illinois Brick*, 431 U.S. at 736 n.16). It then asserted that this Court had "cautioned lower federal

2. The panel majority thus erred in discarding this Court's overarching deterrence rationale and mechanically applying the two *Illinois Brick* factors to this conspiracy case. First, the panel majority tersely concluded that *Illinois Brick*'s price-tracing concern was applicable because, "to calculate the 'but-for' price [that would have prevailed absent the conspiracy], the court would be required to determine the over-charge, if any, for Microsoft's software that was passed on to consumers – the exact analysis that *Illinois Brick* forbids." Pet. App. 31a. Even if the panel majority's unfounded conclusion were correct, *Illinois Brick*'s price-tracing concern must be deemed inapplicable in view of the failure of the indirect purchaser rule to provide adequate antitrust deterrence where the so-called direct purchaser has joined an antitrust conspiracy.

In any case, contrary to the panel majority's unreasoned conclusion, no pass-through analysis is necessary or appropriate here, and the court did not (because it could not) explain how that could be so. The reason that the (non-conspiracy) claim in *Illinois Brick* would have required a pass-through analysis was to *allocate* the damages between the direct and indirect purchasers – neither of which was in cahoots with the upstream supplier. In an antitrust conspiracy, however, there can be *no* such allocation: the conspirators are jointly and severally liable for *all* damages caused by their unlawful conspiracy, and

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courts against creating new exceptions to the *Illinois Brick* rule" in *UtiliCorp*. *Id.* The Court's rationale for these exceptions is that "market forces have been superseded," *Illinois Brick*, 431 U.S. at 736 n.16, which is exactly the case here. By virtue of the conspiracy, the normal "complex market interactions" between Microsoft and the OEM defendants were "circumvent[ed]," *id.* at 736 – just as when the direct purchaser is owned or controlled by its customer. Notably, none of the decisions declining to apply the indirect purchaser rule read *UtiliCorp* in this way. To the contrary, Judge Easterbrook recently wrote for the Seventh Circuit that holding an antitrust conspiracy outside *Illinois Brick*, and thus holding each conspirator jointly and severally liable for the conspiracy's entire sales, "is compatible with . . . *UtiliCorp*." *Paper Sys.*, 281 F.3d at 633.

plaintiffs are direct purchasers from the conspiracy. *See Texas Indus., Inc. v. Radcliff Materials, Inc.*, 451 U.S. 630, 639 (1981) (holding that there is no right of contribution among antitrust co-conspirators); *Paper Sys.*, 281 F.3d at 632-33 ("Holding [one conspirator] jointly and severally liable with the other[s], for the conspiracy's entire sales, is compatible with *Hanover Shoe*, *Illinois Brick*, and *Utili-Corp*. Certainly it does not undermine these decisions, which are themselves designed to improve deterrence").

As the dissent pointed out, "[h]ow much of its monopoly profits Microsoft retained is merely a matter of how the conspirators allocated the fruits of their alleged illegality, and is not directly relevant to Gravity. The damages that Gravity is seeking to prove are the difference between the price consumers actually paid for the Windows software and the 'but for' price." Pet. App. 43a. "Gravity is not complaining about any overcharge paid by the OEMs to Microsoft. Rather, Gravity is complaining about the conspiracy's ultimate overcharge of the consumer." *Id.*

To be sure, calculating the "but for" price in the absence of the unlawful agreements between the OEM defendants and Microsoft may present certain difficulties. For example, defendants have steadily relied on the fact that doing so will require disaggregating the sale price of Microsoft software from the sale price of the OEMs' computers on which it was installed. But that is no concern of *Illinois Brick* and would occur, for example, if Microsoft built and sold its own brand of Windows-operated PC. *See id.* at 43a-44a. Uncertainties or difficulties in ascertaining damages resulting from the defendants' misconduct do not preclude recovery in an antitrust action. *See Bigelow v. RKO Radio Pictures, Inc.*, 327 U.S. 251, 265 (1946) ("[I]n cases where a wrongdoer has incorporated the subject of a plaintiff's patent or trade-mark in a single product to which the defendant has contributed other elements of value or utility, . . . this Court has sustained recovery of the full amount of defendant's profits where his own wrongful action has made it impossible for the plaintiff to

show in what proportions he and the defendant have contributed to the profits."); *J. Truett Payne Co. v. Chrysler Motors Corp.*, 451 U.S. 557, 566-67 (1981) ("[I]t does not come with very good grace for the wrongdoer to insist upon specific and certain proof of the injury which it has itself inflicted.") (internal quotation marks omitted).

"The real concern of *Hanover Shoe* and *Illinois Brick* is the complexity of measuring the pass-on of an *actual* overcharge, and its potential negative effect on deterrence and compensation, not the mere difficulties of determining what the price would have been in a competitive market." Dissent, Pet. App. 44a. Every antitrust suit confronts that problem because the plaintiff must show how far the defendant suppressed competition. The majority's reasoning "is essentially a free pass to any conspiracy that can make the damage it inflicts difficult to pin down." *Id.* at 44a-45a.

Accordingly, the panel majority's mechanical application of the price-tracing concern is both wrong on its own terms and divorced from the non-conspiracy context that spawned it. Attempting to sidestep that problem with its reasoning, the panel majority conjured up a fear that "the *Illinois Brick* rule would be inverted solely based upon artful pleading." *Id.* at 30a. But such hypothetical abuses of pleading rules – which may of course be sanctioned under Federal Rule of Civil Procedure 11 – provide no support for the panel majority's "troubling [and] unhesitating willingness to cut off compensation to *all* injured consumers. . . . Moreover, the concern about 'artful pleading' has nothing whatsoever to do with *Illinois Brick* and *Hanover Shoe*. The direct purchaser rule is designed to *encourage* and *incentivize* private enforcement of the antitrust laws, not immunize corporate wrongdoers from having to litigate antitrust claims." Dissent, *id.* at 45a.

The panel majority also held that the multiple-recovery concern of *Illinois Brick* is present because the OEMs might have sued Microsoft. *See id.* at 31a. (They did not.) *Illinois Brick* held that the antitrust laws are better

served by allowing the direct purchaser to sue, *see* 431 U.S. at 746, but that deterrence rationale fails once the "direct" purchaser joins a conspiracy; at that point, the direct purchaser becomes the consumer who buys directly from any member of the conspiracy. It makes no sense to apply *Illinois Brick* merely because a co-conspirator conceivably might have sued its partner in anticompetitive conduct. Such a rule would only encourage suppliers and distributors to conspire with each other and thereby create immunity – precisely the opposite of the deterrence that *Illinois Brick* sought to achieve.[13] In any case, because there is no right of contribution among antitrust co-conspirators, there could be no double recovery from Microsoft by the OEMs. *See Texas Indus.*, 451 U.S. at 639; *Paper Sys.*, 281 F.3d at 632-33; *Lowell*, 177 F.3d at 1230 ("Although Plaintiffs may sue [the manufacturer] alone for the full cost of the conspiracy with the dealers, that is the way antitrust conspiracy liability works and does not go to the kind of duplicative recovery with which *Illinois Brick* was concerned.").

CONCLUSION

The petition for a writ of certiorari should be granted.

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[13] Indeed, Compaq and Dell successfully urged the State of Texas not to join the government's suit against Microsoft. *See* Robert W. Hahn, *The Costs of Regulating Microsoft*, 21 Regulation 62, 67 (1998) ("The Texas attorney general . . . investigated Microsoft, but withdrew just before the case was filed as objections were raised by Dell, Compaq, and Computer City – all major Texas computer firms.").

Respectfully submitted,

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March 4, 2003

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APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

No. 01-2458

MARK H. DICKSON, *Plaintiff-Appellant*,
AND
CAREY D. EBERT, TRUSTEE IN BANKRUPTCY
FOR GRAVITY, INC., *Trustee-Appellant*,
AND
403 WEST LOOP 820 N, *Plaintiff*,

v.

MICROSOFT CORPORATION;
COMPAQ COMPUTER CORPORATION; DELL COMPUTER;
PACKARD BELL NEC, INC.,
Defendants-Appellees.

[Argued June 5, 2002]
[Decided October 28, 2002]

On Appeal from the United States District Court
for the District of Maryland

Before WILLIAMS and GREGORY, Circuit Judges, and MICHAEL, JR., Senior United States District Judge for the Western District of Virginia, sitting by designation.

Affirmed by published opinion. Judge WILLIAMS wrote the majority opinion, in which Senior Judge Michael joined. Judge GREGORY wrote a dissenting opinion.

OPINION

WILLIAMS, Circuit Judge.

Mark H. Dickson and Carey D. Ebert, trustee in bankruptcy for Gravity, Inc., (collectively, Gravity) appeal the district court's dismissal under Federal Rule of Civil Procedure 12(b)(6) of Gravity's consumer class action claims against Microsoft Corporation and three original equipment manufacturers (OEMs) – Compaq Computer Corporation (Compaq), Dell Computer Corporation (Dell), and PB Electronics, Inc. (PB) (collectively, the OEM Defendants) – in the United States District Court for the District of Maryland. For the reasons set forth below, we affirm.

I.

In February 1999, Gravity filed this action in the United States District Court for the District of Columbia, alleging a "hub-and-spoke" conspiracy between Microsoft and the OEM Defendants to restrain trade, in violation of § 1 of the Sherman Act, and a conspiracy to maintain Microsoft's alleged monopolies[1] in the sale of operating systems,[2] word processing, and spreadsheet software, in violation of § 2 of the Sherman Act.[3] The proposed class

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[1] The Supreme Court defines monopoly power as "the power to control prices or exclude competition." *United States v. E.I. du Pont de Nemours & Co.*, 351 U.S. 377, 391, 76 S.Ct. 994, 100 L.Ed. 1264 (1956). "More precisely, a firm is a monopolist if it can profitably raise prices substantially above the competitive level." *United States v. Microsoft Corp.*, 253 F.3d 34, 51 (D.C.Cir.2001) (citing 2A Phillip E. Areeda & Herbert Hovenkamp, *Antitrust Law* ¶ 501, at 85 (1995)). As the D.C. Circuit noted, "merely possessing monopoly power is not itself an antitrust violation," but "it is a necessary element of a [Section 2] monopolization charge." *Id.*

[2] Operating systems function as platforms for software applications, such as word processing and spreadsheet programs.

[3] Gravity also asserted a class action claim against Microsoft individually for monopolization of case management and litigation support software, but Gravity has voluntarily dismissed this claim with prejudice.

action consists of two separate classes. The first class is composed of "United States purchasers, between October 20, 1993 and the present, of Microsoft Windows or MS DOS operating software . . . installed and sold with personal computers compatible with Intel x86/Pentium architecture purchased directly from Compaq, Dell, or [PB]." (J.A. at 103.) The second class is composed of "United States purchasers, between October 20, 1993 and the present, of Microsoft word processing software and/or Microsoft spreadsheet software installed and sold with personal computers compatible with Intel x86/Pentium architecture purchased directly from Compaq, Dell, or [PB]." (J.A. at 103.)

Gravity alleges that the OEM Defendants and Microsoft violated the Sherman Act by entering into licensing agreements with the following anticompetitive provisions: (1) a prohibition against removing icons, folders, or Start menu entries from the Windows desktop; (2) a prohibition against modifying the initial Windows boot sequence; (3) the integration of Internet Explorer (IE), Microsoft's Internet browser software, and other application software with Microsoft's operating software; and (4) the inclusion of long-term distribution contracts, exclusive dealing distribution arrangements, and per-processor license fees.[4]

In exchange for agreeing to these provisions, the OEM Defendants allegedly received various benefits, including discounts on software and "greater cooperation from Microsoft in product development." *Gravity, Inc. v. Microsoft Corp.*, 127 F.Supp.2d 728, 732 n. 5 (D.Md.2001); *see also United States v. Microsoft Corp.*, 84 F.Supp.2d 9, 42 (D.D.C.1999) (stating that Compaq and several other OEMs enjoyed "early access to Windows source code"). Gravity also alleges that the agreements benefitted the

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[4] Per-processor license fees are royalties that Microsoft requires the OEM Defendants to pay for personal computers that are sold pursuant to the licensing agreement containing a "particular microprocessor type." *United States v. Microsoft Corp*, 1995 WL 505998, at *2 (D.D.C. Aug.21, 1995).

OEM Defendants by allowing them to sell more computer hardware than they would have sold if the relevant software markets were competitive and by ensuring that the OEM Defendants would not be undercut by rivals offering either comparable hardware with lower-priced software or comparable hardware without software.

Gravity claims that the restrictive licensing agreements were predicated, at least in part, on the perceived threat from emerging "middle-ware" platforms. Gravity's theory is that middleware platforms feasibly could replace most operating software functions by allowing developers to write programs interfacing with middleware rather than the operating system.[5] *United States v. Microsoft Corp.*, 253 F.3d 34, 74 (D.C.Cir.2001). The D.C. Circuit has explained the threat of middleware platforms to Microsoft's monopoly in the operating systems market as follows:

> If a consumer could have access to the applications he desired – regardless of the operating system he uses – simply by installing a particular browser on his computer, then he would no longer feel compelled to select Windows in order to have access to those applications; he could select an operating system other than Windows based solely upon its quality and price. In other words, the market for operating systems would be competitive.

Id. at 60. Gravity also alleges that Microsoft has faced challenges from competing operating software, such as DR DOS.

The restraints on trade in the licensing agreements allegedly have denied the class members the choice of competitive software products and have resulted in supra-competitive prices for Microsoft's operating system and application software. Gravity does not allege any conspiracy between Microsoft and the OEM Defendants to set the resale price of the software. Instead, it claims that

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[5] Netscape Navigator and the Java programming language are examples of middleware products written for multiple operating systems.

overcharges were passed on to the consumers by the OEM Defendants when the consumers purchased personal computers (PCs) from the OEM Defendants.

Microsoft and the OEM Defendants moved to dismiss the First Amended Complaint (FAC). While those motions were under submission, the Judicial Panel on Multidistrict Litigation transferred the action to the United States District Court for the District of Maryland, where it was coordinated with approximately sixty-four other antitrust actions against Microsoft. The other antitrust actions were consolidated into a single class action. Gravity's complaint was not consolidated with these actions because it was the only complaint alleging claims against OEMs as defendants. *In re Microsoft Corp. Antitrust Litig.*, 127 F.Supp.2d 702, 704 & n. 2 (D.Md.2001).

In January 2001, the district court dismissed Gravity's FAC for failure to state a claim. Following this dismissal, Gravity moved for leave to file a Second Amended Complaint (SAC). In the SAC, Gravity alleged two separate vertical conspiracies between Dell and Microsoft and Compaq and Microsoft.[6] Gravity did not name PB as a defendant.[7] Gravity repeated its allegations of anticompetitive conduct and included a claim that Microsoft's licensing agreements "bundl[ed] or t[ied] the distribution of Microsoft's middleware, the Internet Explorer browser, with Microsoft's Windows operating software." (J.A. at 465.) The district court denied leave to file the SAC on the ground of futility, concluding that the SAC also failed to state a claim upon which relief could be granted.

On appeal, Gravity contends that both complaints allege proper claims under § 1 and § 2 of the Sherman Act. Gravity also argues that the district court erred in apply-

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[6] For a discussion of the distinction between a "hub-and-spoke" conspiracy and separate vertical conspiracies, *see infra* at 202-03.

[7] Gravity did not allege a separate conspiracy between Microsoft and PB in the SAC because none of the named plaintiffs purchased a PC from PB. (Appellant's Br. at 20 n. 5.)

ing the indirect purchaser rule of *Illinois Brick Co. v. Illinois*, 431 U.S. 720, 97 S.Ct. 2061, 52 L.Ed.2d 707 (1977), to foreclose compensatory damages. We address each argument in turn.

II.

Before turning to our consideration of Gravity's claims of error, a brief overview of the public enforcement action for injunctive relief brought by the federal government and nineteen states against Microsoft in the United States District Court for the District of Columbia is warranted.[8] *See United States v. Microsoft Corp.*, 253 F.3d 34 (D.C.Cir.2001). In analyzing the § 2 claim against Microsoft, the D.C. Circuit upheld the district court's finding that Microsoft has monopoly power in the market for operating system software for Intel-compatible PCs with its Windows software, which has gained more than 95% market share. *See id.* at 51-58. It further affirmed the district court's finding that Microsoft had "engag[ed] in exclusionary [or anticompetitive] conduct 'as distinguished from growth or development as a consequence of a superior product, business acumen, or historic accident'" for the purpose of maintaining its monopoly power in the operating systems market. *Id.* at 58. In detailing Microsoft's anti-competitive conduct, the D.C. Circuit relied primarily on the same licensing agreements underlying Gravity's complaint, although it focused on Microsoft's dealings with all of the OEMs who entered into such agreements in the aggregate rather than two or three agreements in isolation. Specifically, the D.C. Circuit highlighted the prohibitions against: "(1) removing any desktop icons, folders, or 'Start' menu entries; (2) altering the initial boot sequence; and (3) otherwise altering the

[8] Although Gravity's complaint was filed prior to resolution of the public enforcement action, the factual predicate is similar, and on appeal, Gravity relies upon many of the D.C. Circuit's findings for general support for its propositions.

appearance of the Windows desktop."[9] *Id.* at 61. It affirmed the district court's conclusion that Microsoft used the restrictions in the licensing agreements to ensure the predominance of IE in the browser market, thereby gaining market share in the browser market for the purpose of maintaining Microsoft's monopoly in the operating systems market.[10] Only the third restriction was held to have been justified by Microsoft's need to protect its copyrighted work. *Id.* at 63. The D.C. Circuit held that the first two restrictions "represent uses of Microsoft's market power to protect its monopoly, unredeemed by any legitimate justification" and, therefore, that Microsoft's imposition of these restrictions violated § 2 of the Sherman Act. *Id.* at 64.

III.

With this background in mind, we evaluate the district court's dismissal of Gravity's complaint. When reviewing the district court's grant of a motion to dismiss a Sherman Act complaint pursuant to Federal Rule of Civil Procedure 12(b)(6), "we must determine whether allegations covering all the elements that comprise the theory for relief have been stated as required." *Estate Constr. Co. v. Miller & Smith Holding Co.*, 14 F.3d 213, 220 (4th Cir.1994) (internal quotation marks omitted) (citing *United States v. Employing Plasterers Ass'n*, 347 U.S. 186, 189, 74 S.Ct. 452, 98 L.Ed. 618 (1954)); *Mun. Utils. Bd. of Albertville v. Ala. Power Co.*, 934 F.2d 1493, 1501 (11th Cir.1991) ("A plaintiff must plead sufficient facts so that each element of the alleged antitrust violation can be identified."). "Moreover, the allegations must be stated in terms that

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[9] For example, the licensing agreements prohibited OEMs from causing any user interface other than the Windows desktop to launch automatically and from adding icons or folders different in size or shape from those supplied by Microsoft.

[10] For a detailed discussion of the relationship between the browser and the operating systems markets and the anticompetitive effect of the license restrictions on the OEMs' ability to promote rival browsers, see *Microsoft*, 253 F.3d at 59-64.

are neither vague nor conclusory." *Estate Constr. Co.*, 14 F.3d at 220-21. "Although we will assume that the plaintiffs can prove the facts that they allege in their complaint, 'it is not . . . proper to assume that . . . the defendants have violated the antitrust laws in ways that have not been alleged.'" *Id.* at 221 (quoting *Associated Gen. Contractors v. Cal. State Council of Carpenters*, 459 U.S. 519, 526, 103 S.Ct. 897, 74 L.Ed.2d 723 (1983)).

At the outset, we note that although Gravity alleges violations of both § 1 and § 2, the district court did not separately examine the sufficiency of Gravity's claims when it dismissed the FAC. The district court determined that the alleged § 1 and § 2 conspiracies were "coterminous" because they purportedly shared a common goal: maintaining Microsoft's monopolies. *Gravity*, 127 F.Supp.2d at 730. Because the conspiracies "coalesce," reasoned the district court, the sufficiency of both allegations "must be gauged by the elements of a section 2 claim." *Id.* "Otherwise, plaintiffs could circumvent the requirements of a conspiracy to monopolize claim, including the requirement that a defendant be shown to have acted with the specific intent to monopolize, simply by characterizing their claim as one arising under section 1, whose elements of proof are not as stringent." *Id.* We disagree with the district court's reasoning in this regard. A § 1 violation "is legally distinct from that under § 2 . . . though the two sections overlap in the sense that a monopoly under § 2 is a species of trade restraint under § 1." *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150, 224 n. 59, 60 S.Ct. 811, 84 L.Ed. 1129 (1940). The same kind of practices, therefore, may evidence violations of both. See *Md. & Va. Milk Pro. Ass'n v. United States*, 362 U.S. 458, 463, 80 S.Ct. 847, 4 L.Ed.2d 880 (1960) ("[S]ections [1 and 2] closely overlap, and the same kind of predatory practices may show violations of [both]."); E. Thomas Sullivan & Jeffrey L. Harrison, *Understanding Antitrust and its Economic Implications* § 6.08, at 258 (2d ed. 1994) ([The prohibition in § 2 against combinations or conspiracies] proscribes a great deal of the same behavior prohibited by § 1). Thus, even if

Gravity failed to allege a § 2 claim, it is possible that it sufficiently alleged a § 1 claim. *See, e.g., Eastman Kodak Co. v. Image Tech. Servs., Inc.*, 504 U.S. 451, 481, 112 S.Ct. 2072, 119 L.Ed.2d 265 (1992) (describing the § 2 standard as "the more stringent monopoly standard").

To establish a violation of § 1 of the Sherman Act,[11] Gravity must prove the following elements: (1) a contract, combination, or conspiracy; (2) that imposed an unreasonable restraint of trade. *Oksanen v. Page Mem'l Hosp.*, 945 F.2d 696, 702 (4th Cir.1991) (en banc). If Gravity is able to prove a violation of § 1, it then must prove the existence of "*antitrust* injury, which is to say injury of the type the anti-trust laws were intended to prevent and that flows from that which makes defendants' acts unlawful." *Atl. Richfield Co. v. USA Petroleum Co.*, 495 U.S. 328, 334, 110 S.Ct. 1884, 109 L.Ed.2d 333 (1990); *Continental Airlines, Inc. v. United Airlines, Inc.*, 277 F.3d 499, 508 (4th Cir.2002); *Oksanen*, 945 F.2d at 708; *see generally* 2 Phillip E. Areeda & Herbert Hovenkamp, *Antitrust Law* ¶¶ 360-63, at 191-227 (1995). These requirements apply with equal force to Gravity's claims for damages and injunctive relief; the only relevant distinction being that for injunctive relief, "the injury itself need only be threatened." 2 Areeda & Hovenkamp ¶ 360b, at 193.

A.

With respect to the first element, in the FAC, Gravity alleged a single "hub-and-spoke," or "rimless wheel" conspiracy among the OEM Defendants and Microsoft. A rimless wheel conspiracy is one in which various defendants enter into separate agreements with a common defendant, but where the defendants have no connection with one another, other than the common defendant's involvement in each transaction. *Kotteakos v. United*

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[11] Section 1 states: "Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is hereby declared to be illegal." 15 U.S.C.A. § 1 (West 1997).

States, 328 U.S. 750, 755, 66 S.Ct. 1239, 90 L.Ed. 1557 (1946) ("[T]he pattern was that of separate spokes meeting at a common center, though we may add without the rim of the wheel to enclose the spokes." (internal quotation marks omitted)). In *Kotteakos*, the Supreme Court made clear that a rimless wheel conspiracy is not a single, general conspiracy but instead amounts to multiple conspiracies between the common defendant and each of the other defendants. *Id.* at 768-69, 772, 66 S.Ct. 1239; Joseph F. McSorley, *A Portable Guide to Federal Conspiracy Law* 145 (1996) ("While the hub may view its dealings with the spokes as part of a single agreement, a spoke may be concerned simply with his or her own actions.").

Gravity does not argue that it is able to meet the test for establishing a "rim" between the OEM Defendants and Microsoft.[12] (Appellant's Br. at 53.) Instead, it urges us to follow the Sixth Circuit, which Gravity asserts has adopted the proposition that a rimless wheel conspiracy constitutes a single, general conspiracy in the context of the Sherman Act. *See Elder-Beerman Stores Corp. v. Federated Dep't Stores, Inc.*, 459 F.2d 138, 146 (6th Cir.1972) (setting forth requirements for proving "rimless wheel" conspiracy); *see also Impro Products, Inc. v. Herrick*, 715 F.2d 1267, 1279 n. 14 (8th Cir.1983) (noting that "[t]here

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[12] A single criminal conspiracy generally is demonstrated by an "overlap of key actors, methods, and goals." *United States v. Strickland*, 245 F.3d 368, 385 (4th Cir.2001) (internal quotation marks and citations omitted); *see also United States v. Bowens*, 224 F.3d 302, 308 (4th Cir.2000) (holding that it was not error for the district court to refuse to instruct the jury on multiple conspiracies where there was evidence of common methods of operation and common participants linked by a mutual interest); *United States v. Squillacote*, 221 F.3d 542, 574 (4th Cir.2000) ("A single conspiracy exists where there is one overall agreement, or one general business venture." (internal quotation marks omitted)). Because Gravity does not argue that its allegations are sufficient to demonstrate this type of overlap but instead only advocates our adopting the concept of a rimless wheel conspiracy, we need not decide whether the same test that applies to demonstrate a single criminal conspiracy would apply in the context of the Sherman Act.

is some question whether the conspiracy provisions of Sections 1 and 2 of the Sherman Act apply to a hub-and-spoke conspiracy," but declining to resolve the issue after suggesting that such a theory was appropriate). Nothing in the Supreme Court's holding in *Kotteakos*, however, suggests that such a proposition is correct or permissible. Rather, the Supreme Court was clear: a wheel without a rim is not a single conspiracy.[13] *Kotteakos*, 328 U.S. at 755, 66 S.Ct. 1239. Thus, we agree with the district court that Gravity's attempt in its FAC to plead a single, rimless wheel conspiracy between the OEM Defendants and Microsoft must be rejected.

In an effort to cure its failure to allege a legally viable conspiracy, Gravity alleged in the SAC separate vertical

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[13] The dissent's confusion in applying *Kotteakos* is understandable by reference to its reliance on the Sixth and Eighth Circuits, both of which appear to have misinterpreted *Kotteakos*. *Post* at [32a-34a] (citing *Elder-Beerman Stores Corp. v. Federated Dep't Stores, Inc.*, 459 F.2d 138 (6th Cir.1972); *Impro Prods., Inc. v. Herrick*, 715 F.2d 1267, 1279 (8th Cir.1983)). In *Elder-Beerman*, the Sixth Circuit stated that "[t]here is much discussion in the *Kotteakos* decision indicating the possibility that such a 'rimless wheel' theory might be used in a civil case though not appropriate in a criminal case." *Elder-Beerman*, 459 F.2d at 147. In *Impro Products*, the Eighth Circuit compounded the Sixth Circuit's error by describing the test set forth in *Elder-Beerman* for a rimless wheel conspiracy (which is adopted by the dissent, *post* at [33a-34a]) and then concluding that a rimless wheel conspiracy constitutes a single conspiracy in civil actions. *Impro Prods.*, 715 F.2d at 1279 & n. 14. Nothing in *Kotteakos* suggests, however, that the definition of a rimless wheel conspiracy turns on whether the conspiracy is civil or criminal in nature; the Sixth and the Eighth Circuits' contrary belief apparently stems from the distinction between criminal and civil actions that was drawn in *Kotteakos* for purposes of analyzing harmless error.

In any event, even if we were to further distort the clear holding set forth in *Kotteakos* by following the Sixth and Eighth Circuits in the manner suggested by the dissent, our resolution of Gravity's claims would be unaffected. Regardless of whether Gravity has alleged a single conspiracy among the OEM Defendants and Microsoft or two separate agreements, its § 1 and § 2 claims would be subject to dismissal for failure to allege facts demonstrating a significant likelihood of anti-competitive effects.

conspiracies between Microsoft and Compaq and between Microsoft and Dell. Compaq and Dell argue that these allegations also are insufficient to demonstrate concerted action under § 1 because Gravity is unable, as a matter of law, to demonstrate that either shared with Microsoft "a unity of purpose or a common design and understanding." *Monsanto Co. v. Spray-Rite Serv. Corp.*, 465 U.S. 752, 764, 104 S.Ct. 1464, 79 L.Ed.2d 775 (1984) (internal quotation marks and citation omitted). As this court recently emphasized in *Virginia Vermiculite, Ltd. v. HGSI*, 307 F.3d 277, (4th Cir.2002), "concerted activity susceptible to sanction by section 1 is activity in which multiple parties join their resources, rights, or economic power together in order to achieve an outcome that, but for concert, would naturally be frustrated by their competing interests (by way of profit-maximizing choices)." *Id.* at *9. Gravity has sufficiently alleged that Microsoft and the OEM Defendants pooled their resources, rights, or economic power. Furthermore, to the extent Compaq and Dell argue that it was against their economic interests to enter into § 1 conspiracies with Microsoft, we note that Gravity has alleged that Compaq and Dell received financial and other benefits in exchange for entering into the licensing agreements. These allegations are sufficient for purposes of Rule 12(b)(6) to demonstrate that a § 1 conspiracy was economically plausible.[14] *Cf., e.g., Spectators' Communication Network, Inc. v. Colonial Country Club*, 253 F.3d 215, 220-22 (5th Cir.2001) (analyzing relevant caselaw and concluding that a vertical conspiracy could be shown under § 1 even though it likely would be against Anheuser

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[14] Arguably, however, these allegations are insufficient as a matter of law to demonstrate that either Compaq or Dell possessed specific intent to maintain Microsoft's alleged monopolies under § 2. *See TV Communications Network, Inc. v. Turner Network Television, Inc.*, 964 F.2d 1022, 1026-27 (10th Cir.1992) ("Because the cable operators would have no rational motive to create [a monopolistic environment], TVCN's allegations do not provide an inference of specific intent to conspire to achieve the stated goal of the conspiracy.").

Busch's economic interest to conspire to restrain competition in a market in which it was a purchaser).

Moreover, "the 'combination or conspiracy' element of a section 1 violation is not negated by the fact that one or more of the co-conspirators acted unwillingly, reluctantly, or only in response to coercion." *MCM Partners, Inc. v. Andrews-Bartlett & Assocs.*, 62 F.3d 967, 973 (7th Cir. 1995); *In re Brand Name Prescription Drugs Antitrust Litig.*, 123 F.3d 599, 615 (7th Cir.1997) (noting that the wholesaler's participation would be actionable even if the jury found that they "were tools of the manufacturers-reluctant accomplices, yet not the less liable for that."); *see also United States v. United States Gypsum Co.*, 438 U.S. 422, 436 n. 13, 98 S.Ct. 2864, 57 L.Ed.2d 854 (1978) ("[T]he general rule [is] that a civil violation can be established by proof of either an unlawful purpose or an anti-competitive effect."). The co-conspirators need not share the same motive or goal; it is sufficient to allege that the co-conspirators "acquiesc[ed] in an illegal scheme." *United States v. Paramount Pictures, Inc.*, 334 U.S. 131, 161, 68 S.Ct. 915, 92 L.Ed. 1260 (1948); *see also Va. Vermiculite, Ltd. v. W.R. Grace & Co.*, 156 F.3d 535, 541 (4th Cir.1998) ("It is not necessary that [Historic Green Springs, Inc.] have shared Grace's alleged anticompetitive motive in entering into a proscribed restraint; it is sufficient that HGSI, regardless of its own motive, merely acquiesced in the restraint with the knowledge that it would have anticompetitive effects."); *Duplan Corp. v. Deering Milliken Inc.*, 594 F.2d 979, 982 (4th Cir.1979) ("Where, as here, the [defendants] were knowing participants in a scheme whose effect was to restrain trade, the fact that their motives were different from or even in conflict with those of the other conspirators is immaterial."). Accordingly, Gravity's allegations regarding the commercial license agreements are sufficient for purposes of 12(b)(6) to set forth two separate vertical conspiracies between Microsoft and Compaq and between Microsoft and Dell.

B.

We next address whether Gravity alleged facts which, if proven true, would establish that the two conspiracies separately imposed unreasonable restraints of trade in interstate commerce. *Continental Airlines*, 277 F.3d at 508. In assessing liability under § 1, courts generally evaluate agreements pursuant to one of three approaches. *Id.* at 508-09 ("[T]he Supreme Court has authorized three methods of analysis: (1) per se analysis, for obviously anti-competitive restraints, (2) quick-look analysis, for those with some procompetitive justification, and (3) the full 'rule of reason,' for restraints whose net impact on competition is particularly difficult to determine."). Because the possibility of anticompetitive effects resulting from either licensing agreement is not obvious, we analyze the two licensing agreements at issue – individually -- pursuant to the "full" rule of reason analysis.[15] *Id.*; *cf.*, *e.g.*, *Microsoft*, 253 F.3d at 59-60 (applying full rule of reason analysis to claimed § 2 violations).

In the rule of reason analysis, "the reasonableness of a restraint is evaluated based on its impact on competition as a whole within the relevant market." *Oksanen*, 945 F.2d at 708. This evaluation requires a showing of "anti-

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[15] Justice Brandeis in *Bd. of Trade of City of Chicago v. United States*, 246 U.S. 231, 38 S.Ct. 242, 62 L.Ed. 683 (1918), explained the rule of reason as follows:

> The true test of legality is whether the restraint imposed is such as merely regulates and perhaps thereby promotes competition or whether it is such as may suppress or even destroy competition. To determine that question the court must ordinarily consider the facts peculiar to the business to which the restraint is applied; its condition before and after the restraint was imposed; the nature of the restraint and its effect, actual or probable. The history of the restraint, the evil believed to exist, the reason for adopting the particular remedy, the purpose or end sought to be attained, are all relevant facts. This is not because a good intention will save an otherwise objectionable regulation or the reverse; but because knowledge of intent may help the court to interpret facts and to predict consequences.

Id. at 238, 38 S.Ct. 242.

competitive effect" resulting from the agreement in restraint of trade. To have an "anticompetitive effect," conduct "must harm the competitive process and thereby harm consumers." *Microsoft*, 253 F.3d at 58. "[H]arm to one or many competitors will not suffice." *Id.* "The [Sherman Act] directs itself not against conduct which is competitive, even severely so, but against conduct which unfairly tends to destroy competition itself." *Id.* (internal quotation marks omitted). Thus, an inquiry into the lawfulness of the restraint begins "by identifying the ways in which a challenged restraint might possibly impair competition." 7 Areeda & Hovenkamp ¶ 1503a, at 372. After identifying the type of possible harm to competition alleged, we must proceed "to determine whether that harm is not only possible but likely and significant," which requires "examination of market circumstances," including market power and share. 7 *id.* ¶¶ 1503a 1503b, at 374-77.

1.

Gravity alleges that Compaq's and Dell's agreements with Microsoft aided the maintenance of Microsoft's monopolies in PC operating system, word processing, and spreadsheet markets. Aiding the maintenance of a monopoly theoretically could harm competition by affecting price and/or output in various ways. For instance, the agreements could allow Microsoft to leverage its market power in the relevant software markets to obtain advantage in some secondary market (such as the browser market), not based upon consumer choice or efficient performance but from the mere fact of Microsoft's market power in the primary market. *See Microsoft*, 253 F.3d at 62-66 (finding anticompetitive effects resulting from Microsoft's licensing agreements with OEMs based upon Microsoft's leveraging of monopoly power in operating system market to suppress competition in the browser market); *see generally* Robin Cooper Feldman, *Defensive Leveraging in Antitrust*, 87 Geo. L.J. 2079, 2080, 2098 (1999) (discussing "traditional leveraging theory" and the "Chicago school" leveraging theory and concluding that "defensive leveraging" can create the potential for harm to consumers by

aiding in the maintenance of the primary monopoly). Similarly, with respect to the exclusive dealing components of the licensing agreements, the potential harm to consumers is that rival software firms or browsers will be foreclosed from access to consumers, denying consumers competitive choice and allowing supracompetitive pricing with respect to the software markets for which Microsoft has monopoly power. Per-processor fees also arguably could "discourage OEMs from licensing competing operating systems and/or cause OEMs to raise the price for PCs with a competing operating system to recoup the fee paid to Microsoft," theoretically resulting in increased prices for Microsoft's software and decreased opportunities for rival software firms to gain access to consumers. *United States v. Microsoft Corp.*, 159 F.R.D. 318, 323 (D.D.C. 1995), *rev'd on other grounds*, 56 F.3d 1448 (D.C.Cir. 1995); *see generally* Kenneth C. Baseman et al., *Microsoft Plays Hardball: The Use of Exclusionary Pricing and Technical Incompatibility to Maintain Power in Markets for Operating System Software*, 40 Antitrust Bull. 265, 267-68 (1995) (criticizing per-processor licenses).

"Theorizing about conceivable impairments of competition does not, of course, prove that any such impairment has occurred or is likely," or much less is "substantial in magnitude."[16] 7 Areeda & Hovenkamp ¶ 1503a, at 373. Thus, we next must examine whether Gravity sufficiently has alleged the likelihood of a substantial anticompetitive harm caused by the two licensing agreements at issue (considered individually), an inquiry that requires Gravity to allege facts demonstrating "that the defendants played a significant role in the relevant market."

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[16] Nor do we suggest whether any such anticompetitive effect, if shown to be likely and substantial in magnitude, would be outweighed by a pro-competitive justification. *See, e.g., Microsoft*, 253 F.3d at 59 (noting, under traditional rule of reason analysis, if the plaintiff successfully demonstrates anticompetitive effect, then the burden shifts to the defendant to proffer a procompetitive justification for its conduct).

Oksanen, 945 F.2d at 709; *see also General Leaseways, Inc. v. Nat'l Truck Leasing Ass'n*, 744 F.2d 588, 596 (7th Cir.1984) (stating that in rule of reason analysis, the plaintiff must "prove that the defendant has sufficient market power to restrain competition substantially . . . . If not, the inquiry is at an end; the practice is lawful"); 7 Areeda & Hovenkamp ¶ 1503b, at 376 ("[V]irtually all courts applying the rule of reason require the plaintiff . . . to show, at a minimum, that the defendants play a significant role in th[e] [allegedly restrained] market.").

2.

Gravity has provided allegations of Microsoft's market power in the relevant software markets, in the form of Microsoft's shares in these markets.[17] Gravity failed, however, to allege facts regarding Compaq's or Dell's market share and concedes that the PC market is "fiercely competitive" and, therefore, that neither Compaq nor Dell has power in the PC market.[18] *Gravity*, 168 F.Supp.2d at

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[17] Gravity alleged that Microsoft "maintained a monopoly share (in the range of 90%) in the personal computer operating software market" throughout the "class periods," (J.A. at 473), and maintained a market share in the range of 80-90% in the word processing and spreadsheet software markets throughout the class period. For antitrust purposes, market power "is the power to force a purchaser to do something that he would not do in a competitive market." *Eastman Kodak Co. v. Image Tech. Servs., Inc.*, 504 U.S. 451, 464, 112 S.Ct. 2072, 119 L.Ed. 2d 265 (1992) (internal quotation marks omitted). "It has been defined as the ability of a single seller to raise price and restrict output." *Id.* (internal quotation marks omitted). Market share is defined as "[t]he percentage of a market that is controlled by a firm." Black's Law Dictionary 971 (6th ed.1991). Market power generally is identified, in part, by examining market share. *See, e.g.*, Andrew Chin, Note, *Antitrust by Chance: A Unified Theory of Horizontal Merger Doctrine*, 106 Yale L.J. 1165, 1169-72 (1997) (discussing movement away from strict reliance on calculation of market share in antitrust analysis). For purposes of Rule 12(b)(6), we consider Gravity's allegations regarding Microsoft's market share sufficient to allege Microsoft's power in the relevant software markets.

[18] Gravity contends that because the relevant markets are in software, there is no need to evaluate Compaq's or Dell's power in the PC market. Compaq's and Dell's power in the PC market is critical in the

544; *see also Digital Equip. Corp. v. Uniq Digital Techs., Inc.*, 73 F.3d 756, 761 (7th Cir.1996) (Easterbrook, J.) ("Computer manufacturers are vigorous rivals; prices drop daily; this is one of our economy's most competitive sectors."). Gravity further concedes that "[t]he only thing that . . . distinguishes [Compaq and Dell] from other OEMs is the alacrity with which they acquiesced in accepting [the licensing] agreements to obtain relatively favorable prices from Microsoft for its products." *Gravity*, 168 F.Supp.2d at 544. Given Gravity's concession that the PC market is "fiercely competitive," and in light of Microsoft's agreements with other OEMs, Gravity is unable, as a matter of law, to demonstrate that Microsoft's agreements with Compaq and Dell, when considered individually, are capable of causing any substantial harm to competition. For instance, without having alleged Compaq's or Dell's power or share in the PC market, Gravity is unable to demonstrate that rival software firms' access *to Compaq or Dell* was an important component of those firms' potential ability to compete in the software markets, or that Microsoft's agreements with Compaq and Dell substantially hindered the entrance or operation of these rivals in the software markets or denied them access to a significant number of consumers of software. Similarly, given the failure to allege the market power of Compaq or Dell, Gravity is unable to show that Compaq or Dell has forced, or is likely to be able to force, supra-competitive prices on consumers for undesirable software features. Consequently, assuming that Compaq and Dell each possessed an insignificant portion of the PC market

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analysis, however, because both OEMs pre-install Microsoft's software on their PCs; neither operates independently in the software market. Thus, Compaq's and Dell's ability to influence competition in the relevant software markets through their separate agreements with Microsoft is dependent on their ability to influence competition in the PC market. *Cf. Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2, 18, 104 S.Ct. 1551, 80 L.Ed.2d 2 (1984) ("[A]ny inquiry into the validity of a tying arrangement must focus on the market or markets in which the two products are sold, for that is where the anticompetitive forcing has its impact.").

and no ability to control pricing or output in the PC market (as is proper in light of Gravity's failure to allege market share or any other facts demonstrating market power), the two licensing agreements – considered individually – would be incapable of succeeding in maintaining or leveraging Microsoft's alleged monopolies, in that neither agreement could substantially reduce the usage share of, or prevent the promotion of, rival browsers, rival operating system software manufacturers, or rival applications software manufacturers.[19] *Cf., e.g., Continental T.V., Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36, 52 n. 19, 54, 97 S.Ct. 2549, 53 L.Ed.2d 568 (1977) (concluding that, although a contractual requirement that distributors sell Sylvania television sets from authorized locations limited competition among the distributors in the resale of Sylvania televisions ("intrabrand competition"), it ultimately *promoted competition* with other brands of television sets ("interbrand competition") and stating that the competitiveness of the interbrand market "provides a significant check on the exploitation of intrabrand market power"); *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2, 13-14, 104 S.Ct. 1551, 80 L.Ed.2d 2 (1984) ("we have condemned tying arrangements when the seller has some special ability – usually called 'market power' – to force a

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[19] Gravity asserts that it need not show that Microsoft's agreements with Compaq and Dell were each a sole cause of any anticompetitive effects but need show only that the agreements were each a "material cause" of anticompetitive effects. *See Zenith Radio Corp. v. Hazeltine Research, Inc.*, 395 U.S. 100, 114 n. 9, 89 S.Ct. 1562, 23 L.Ed.2d 129 (1969) ("It is enough that the illegality is shown to be a material cause of the injury; a plaintiff need not exhaust all possible alternative sources of injury in fulfilling his burden of proving compensable injury under § 4."). Without an allegation of market share or market power of either Compaq or Dell, however, Gravity cannot make the latter showing. *Cf. Brunswick Corp. v. Pueblo Bowl-O-Mat*, 429 U.S. 477, 487-88, 97 S.Ct. 690, 50 L.Ed.2d 701 (1977) (holding that an antitrust claim fails as a matter of law when the plaintiff would have suffered the identical loss without regard to the claimed anticompetitive conduct); 2 Areeda & Hovenkamp ¶ 363a-b, at 219-23 (noting that no material cause can be demonstrated where an independent cause fully accounts for the claimed antitrust injury).

purchaser to do something that he would not do in a competitive market"); *id.* at 16, 104 S.Ct. 1551 ("If only a single purchaser were 'forced' with respect to the purchase of a tied item, the resultant impact on competition would not be sufficient to warrant the concern of antitrust law . . . . [W]e have refused to condemn tying arrangements unless a substantial volume of commerce is foreclosed thereby."); *id.* at 37-38, 97 S.Ct. 2549 (O'Connor, J., concurring) (evaluating tie – ins and noting that to show an adverse impact on consumers, the plaintiff generally must demonstrate two things: market power in the tying – product market and a threat that the seller will acquire market power in the tied – product market); *Digital Equip. Corp.*, 73 F.3d at 761 (Easterbrook, J.) ("Let us ask, then, whether the inclusion of an [operating system] with one's [PC] – 'tie-in' or not – is a means to reduce output and create monopoly profits. Unless the seller has market power, the answer is no . . . ."); *id.* at 762 ("In a competitive market a pig-headed refusal to satisfy customers' preferences, or an attempt to charge for unwanted items, does not lead to monopoly prices; instead it leads to ruin as rivals step in to take the business."). Moreover, with respect to the exclusive dealing component of Gravity's claim, absent an allegation regarding Compaq's or Dell's power or share in the PC market, there is no basis in Gravity's complaint for concluding that either of the two licensing agreements at issue, when considered individually, are likely to foreclose a significant share of the relevant software markets. *See Tampa Electric Co. v. Nashville Coal Co.*, 365 U.S. 320, 327, 81 S.Ct. 623, 5 L.Ed.2d 580 (1961) (holding that an exclusive contract does not violate the Clayton Act unless its probable effect is to "foreclose competition in a substantial share of the line of commerce affected"); *Microsoft*, 253 F.3d at 68-70 (discussing the exclusive dealing aspects of Microsoft's agreements and concluding that, even when the cumulative effect of Microsoft's agreements were considered, the agreements did not foreclose enough of the relevant browser market to constitute a § 1 violation).

The district court afforded Gravity ample opportunity to allege facts demonstrating Compaq's or Dell's power in the PC market, but Gravity refused, contending for various reasons that Compaq's and Dell's power and share in the PC market is immaterial to Compaq's and Dell's (separate) ability to influence competition in the relevant software markets.[20] On appeal, it continues to assert that, as a matter of law, Compaq's and Dell's power in the PC market is irrelevant to its § 1 claim because Microsoft's monopoly power, in a variety of ways, is adequate to demonstrate the likelihood of substantial anti-competitive effects. We address each argument below.

Gravity first argues that Microsoft's significant market power in the software markets is sufficient to demonstrate anticompetitive effects in those markets without regard to Compaq's or Dell's power or share in the PC market. The relevant focus of the § 1 inquiry, however, is the anticompetitive effects of the conspiracy qua conspiracy; therefore, the plaintiff must demonstrate that the conspiratorial agreement itself affected competition in ways that would not have obtained absent the agreement. *Spectators' Communication Network*, 253 F.3d at 225 (not-

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[20] Gravity did allege that Compaq and Dell were the "largest PC makers" and were "among the largest distributors of Microsoft's products." (Appellant's Br. at 11.) The dissent relies on this as a sufficient allegation of Compaq and Dell's respective influences in the PC market. *Post* at [35a-36a]. Being the "largest" in a relevant market, however, says nothing of a firm's ability to affect competition in that market. For example, Compaq and Dell each may possess only five percent of the market share, whereas many other OEMs each possess four percent of the market share, in which case, despite being the largest PC makers and software distributors, neither Compaq nor Dell would have the ability, through their separate conspiracies with Microsoft, to affect competition in the relevant software markets. *Cf., e.g., Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2, 26 & n. 43, 104 S.Ct. 1551, 80 L.Ed.2d 2 (1984) (holding, as a matter of law, that thirty percent share of the relevant market is insufficient to confer market power). Accordingly, Gravity's allegations that Compaq and Dell were the largest PC makers and software distributors provide no basis whatsoever to conclude that either had sufficient share of the PC market to affect competition in the relevant software markets.

ing that the issue is "whether the combination or conspiracy, not each individual conspirator, has the [market] power to hurt competition in the relevant market."); *FTC v. Ind. Fed'n of Dentists*, 476 U.S. 447, 460, 106 S.Ct. 2009, 90 L.Ed.2d 445 (1986) ("[T]he purpose of the inquiries into market definition and market power is to determine whether *an arrangement* has the potential for genuine adverse effects on competition." (emphasis added)). To be sure, one can imagine circumstances in which the allegation of one conspirators' market power is sufficient to demonstrate a likelihood of anticompetitive effects. For instance, assuming as true Gravity's allegations regarding Microsoft's market share in the relevant software markets, had Microsoft agreed to sell its software *only* to Compaq and Dell, such an agreement would have had the potential to harm competition in software markets, and ultimately in the PC market, irrespective of Compaq's or Dell's power or share in the PC market. No such arrangement, however, is alleged here.

Gravity next argues that the district court should have evaluated Microsoft's "exclusionary conduct both inside and outside the combinations alleged," and the potential for anticompetitive effects resulting from this conduct in the aggregate. (Appellant's Br. at 49-50.) The SAC, however, did not allege a conspiracy among Microsoft and all OEMs; it alleged discrete conspiracies between Microsoft and Compaq and Microsoft and Dell. Consequently, the district court correctly determined that it could not consider the cumulative harm of Microsoft's agreements with all OEMs but instead was required to consider – individually – Microsoft's agreements with Compaq and Dell to evaluate each agreement's potential for anticompetitive effects.[21]

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[21] The cumulative harm of Microsoft's actions "outside" the two licensing agreements at issue has been subject to review in the public enforcement action and will be further subject to review in the consumer class actions brought against Microsoft individually and in any suits brought by OEMs against Microsoft. As noted above, *supra* at

Likewise, it is untrue that Compaq and Dell, as alleged co-conspirators of Microsoft, are responsible for all of Microsoft's unilateral acts with other OEMs who were not members of the alleged conspiracies. As noted above, each licensing agreement must be treated as a separate conspiracy, and only acts taken in furtherance of that alleged conspiracy are appropriately considered in determining the adverse effects of the claimed restraints on trade, not acts of one conspirator taken in furtherance of other possible, distinct conspiracies. *Cf. United States v. Bonetti*, 277 F.3d 441, 447 (4th Cir.2002) (noting, in a criminal conspiracy, that a co-conspirator is liable for "all substantive offenses of his co-conspirator that are both reasonably foreseeable and in furtherance of the conspiracy"); *cf. also United States v. Santiago*, 906 F.2d 867, 872-73 (2d Cir.1990) (concluding that the single conspiracy test applies to determine whether co-conspirator conduct is reasonably foreseeable and in furtherance of the conspiracy); *United States v. Gooden*, 892 F.2d 725 (8th Cir.1989) (same). Indeed, to hold otherwise would be to suggest that the distinction between a single conspiracy and multiple conspiracies involving a common defendant is one without a difference.

Thus, we agree with the district court that for Gravity to state a viable § 1 claim, it was required to allege facts which, if proven true, would demonstrate that Compaq's or Dell's individual agreements with Microsoft were likely to result in an anticompetitive effect. Without alleging facts demonstrating Compaq's or Dell's power or share in the PC market, Gravity was unable to make such a showing.

Similarly, without allegations regarding the market power or share of Compaq or Dell in the PC market, Gravity is unable to show a conspiracy to monopolize under

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209-10, the focus of this § 1 inquiry is not Microsoft's actions standing alone, but the extent to which its concerted actions with each of the two individual OEMs promoted Microsoft's monopoly power or otherwise restrained trade.

§ 2.[22] *See* 3A Areeda & Hovenkamp ¶ 809, at 370 ("[I]n those instances where power is a prerequisite to holding an agreement to be an unreasonable restraint of trade [under § 1] . . . it would make no sense to hold the same agreement offensive to § 2 without proof of power."). The offense of monopolization requires a showing of "anticompetitive effect." *Microsoft*, 253 F.3d at 58. Thus, a viable § 2 conspiracy to monopolize claim must include allegations which, if proven true, would establish that the agreements Compaq and Dell made with Microsoft could have had an anticompetitive effect (when considered separately). *See, e.g., id.* at 50 (discussing the meaning of "monopolization" within § 2); *U.S. Anchor Mfg., Inc. v. Rule Industries, Inc.*, 7 F.3d 986, 1001 (11th Cir.1993) (listing the likelihood of an anticompetitive effect as one of the elements of a conspiracy to monopolize under § 2); *Seagood Trading Corp. v. Jerrico, Inc.*, 924 F.2d 1555, 1576 (11th Cir.1991) ("[A] section 1 claim and a section 2 conspiracy to monopolize claim require the same threshold showing – the existence of an agreement to restrain trade."). Accordingly, for the reasons set forth above regarding the inadequacies in Gravity's § 1 allegations, Gravity's § 2 claim also fails as a matter of law.

Gravity suggests that these conclusions are irreconcilably at odds with the D.C. Circuit's conclusions in the public enforcement action, contending that the D.C. Circuit implicitly recognized that Microsoft's licensing agreements with Compaq and Dell violated § 1. This contention, however, misapprehends the nature of the D.C. Circuit's holding. Notably, the district court in the public enforcement action held that the exclusive dealing arrangements in Microsoft's licensing agreements, including

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[22] Section 2 states:

> Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nationals, shall be deemed guilty of a felony. . . .

15 U.S.C.A. § 2 (West 1997).

its agreement with Compaq, did not violate § 1 under the rule of reason, concluding "that Microsoft's arrangements with various firms did not foreclose enough of the relevant market to constitute a § 1 violation." *United States v. Microsoft*, 87 F.Supp.2d 30, 53 (D.D.C.2000). The only § 1 violation found by the district court was based upon Microsoft's alleged tying of Windows and IE, and the D.C. Circuit vacated that ruling. *Microsoft*, 253 F.3d at 84-95. Moreover, in conducting its § 2 analysis, the D.C. Circuit evaluated the anticompetitive effects of Microsoft's licensing agreements with *all* OEMs. Of course, as is set forth above, the analysis of anticompetitive effects depends on the identification of the defendants' "significant role" within the relevant market – an inquiry that is much different when examining the cumulative harm of Microsoft's conduct than it is when examining the effects of Microsoft's individual agreements with two OEMs for which Gravity declines to provide information regarding market share or power. Thus, nothing in the public enforcement action suggests that Gravity's § 1 and § 2 claims are viable.

We recognize that "summary procedures should be used sparingly in complex antitrust litigation where motive and intent play leading roles," *Poller v. Columbia Broadcasting Sys.*, 368 U.S. 464, 473, 82 S.Ct. 486, 7 L.Ed.2d 458 (1962), and that an antitrust complaint should not be dismissed at the Rule 12(b)(6) stage "merely because the court doubts the plaintiff will ultimately prevail," *Advanced Health-Care Servs., Inc. v. Radford Cmty. Hosp.*, 910 F.2d 139, 145 n. 8 (4th Cir.1990) (internal quotation marks omitted). Nevertheless, to avoid dismissal for failure to state a claim, the plaintiff must "colorably state[ ] facts which, if proven, would entitle him to relief." *Id.* (internal quotation marks omitted). We consistently have held this to require an allegation of facts supportive of each element of the plaintiff's antitrust claim. *Estate Constr. Co.*, 14 F.3d at 220 (holding that "notice pleading" requires "allegations covering all the elements that comprise the theory for relief" (internal quotation marks

omitted); *Mun. Utils. Bd. of Albertville*, 934 F.2d at 1501 ("A plaintiff must plead sufficient facts so that each element of the alleged antitrust violation can be identified."). "A contrary view would be tantamount to providing antitrust litigation with an exemption from Rule 12(b)(6)." *Car Carriers, Inc. v. Ford Motor Co.*, 745 F.2d 1101, 1106-07 (7th Cir.1984).

Although Gravity alleges that Microsoft's agreements with Compaq and Dell individually produced anticompetitive effects, it does not provide any factual basis to support this allegation.[23] Moreover, Gravity has made clear that it has no intention of providing evidence regarding the market power or share of Compaq or Dell; thus, it does not seek additional discovery or factual development with respect to the issue of market share or power. Instead, it asks us to accept its conclusory assertion that Microsoft's agreements with Compaq and Dell, when considered individually, created a likelihood of significant anticompetitive effects in the relevant software markets without regard to Compaq's or Dell's market power or share in the PC market. This we cannot do. "The pleader may not evade [Rule 12(b)(6)] requirements by merely alleging a bare legal conclusion; if the facts do not at least outline or adumbrate a violation of the Sherman Act, the plaintiffs will get nowhere merely by dressing them up in the language of antitrust." *Car Carriers, Inc.*, 745 F.2d at 1106 (internal quotation marks omitted). Because Gravity has failed to allege facts which, if true, would establish that the two licensing agreements at issue are unreasonable restraints on trade that caused antitrust injury to consumers, its § 1 and § 2 claims fail as a matter of law. *Cf. Dunn & Mavis, Inc. v. Nu-Car Driveaway, Inc.*, 691 F.2d 241, 245 (6th Cir.1982) ("Since the complaint does not allege facts suggesting that [the manufacturer's] re-

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[23] While the dissent notes as "unexceptional" the proposition that a plaintiff may not rely on a bare legal conclusion to avoid dismissal under Rule 12(b)(6), it proceeds to rely solely on Gravity's bare legal conclusions to find its complaint sufficient. *Post* at [41a] n. 1.

fusal to deal had any significant anticompetitive effect on the market, there is no rule of reason case alleged.").

This court recently concluded that the Supreme Court's holding in *Swierkiewicz v. Sorema, N.A.*, 534 U.S. 506, 122 S.Ct. 992, 152 L.Ed.2d 1 (2002), did not alter the basic pleading requirement that a plaintiff set forth facts sufficient to allege each element of his claim. *See Iodice v. United States*, 289 F.3d 270, 281 (4th Cir.2002) ("Even in these days of notice pleadings a complaint asserting a negligence claim must disclose that each of the elements is present in order to be sufficient." (internal citations and quotation marks omitted)); *see also Swierkiewicz*, 122 S.Ct. at 997 (relying upon a distinction between "evidentiary standards" and "pleading requirement[s]"). As the dissent recognizes, a sufficient allegation of anticompetitive effects is dependent upon Compaq's and Dell's respective abilities to affect competition in the PC market. *Post* at [38a] ("[I]f the conspiracy included only minor OEMs, then the conspiracy would presumably have no power to cause significant anticompetitive effects."). Consequently, by failing to allege Compaq's and Dell's market share or power, Gravity has failed to set forth factual allegations necessary to support the basic elements of its § 1 and § 2 claims. *See McLain v. Real Estate Bd. of New Orleans*, 444 U.S. 232, 243, 100 S.Ct. 502, 62 L.Ed.2d 441 (1980) (noting that to establish liability under the Sherman Act, a showing of either an anticompetitive effect or an anticompetitive purpose is necessary).

IV. *Illinois Brick*

Even if we agreed with Gravity that it has alleged sufficient claims under § 1 and § 2 for purposes of Rule 12(b)(6), we would affirm the district court's conclusion that Gravity is barred from seeking compensatory damages relief under the indirect purchaser rule of *Illinois Brick Co. v. Illinois*, 431 U.S. 720, 97 S.Ct. 2061, 52

L.Ed.2d 707 (1977).[24] A brief review of the evolution of the indirect purchaser rule is helpful to understand its application to Gravity's claims. In *Hanover Shoe, Inc. v. United Shoe Mach. Corp.*, 392 U.S. 481, 88 S.Ct. 2224, 20 L.Ed.2d 1231 (1968), the defendant in a Sherman Act suit, a manufacturer of machinery for making shoes, defended on the ground that the plaintiff, a shoe manufacturer that had bought the defendant's machinery, had passed on any monopoly overcharge to its own customers, the wholesale purchasers its shoes, and hence had not been injured. The Supreme Court held that an antitrust defendant would not be permitted to defend against a damages suit on the ground that the plaintiff had shifted the cost of the defendant's wrongdoing to the plaintiff's customers. The Court explained the rationale for its decision as follows:

> Even if it could be shown that the buyer raised his price in response to, and in the amount of, the overcharge and that his margin of profit and total sales had not thereafter declined, there would remain the nearly insuperable difficulty of demonstrating that the particular plaintiff could not or would not have raised his prices absent the overcharge or maintained the higher price had the overcharge been discontinued. Since establishing the applicability of the passing – on defense would require a convincing showing of each of these virtually unascertainable figures, the task would normally prove insurmountable.

Id. at 493, 88 S.Ct. 2224. The *Hanover Shoe* Court further explained that the plaintiff's customers "would have only a tiny stake" in enforcing the anti-trust law. *Id.* at 494, 88 S.Ct. 2224.

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[24] *Illinois Brick*'s indirect purchaser rule, when applicable, bars only compensatory damages relief and does not apply to injunctive relief. *See Cargill, Inc. v. Monfort of Colorado*, 479 U.S. 104, 111 n. 6, 107 S.Ct. 484, 93 L.Ed.2d 427 (1986); *Campos v. Ticketmaster*, 140 F.3d 1166, 1172 (8th Cir.1998); *McCarthy v. Recordex Serv., Inc.*, 80 F.3d 842, 856-57 (3d Cir.1996).

In *Illinois Brick*, plaintiffs, who were indirect purchasers of concrete blocks, sought to recover damages on the theory that masonry contractors, who incorporated concrete blocks purchased from defendants into walls and other masonry structures, passed on the alleged overcharge for the blocks to general contractors, who incorporated the masonry structures into entire buildings, and that the general contractors in turn passed on the overcharge to plaintiffs in the bids submitted for those buildings. *Illinois Brick*, 431 U.S. at 726-27, 97 S.Ct. 2061. The Court extended the *Hanover Shoe* rule and held that only direct purchasers from an antitrust violator can sue for damages, providing two rationales for the rule: it avoids the danger of multiple, "overlapping recoveries" against the original seller by direct and indirect purchasers, and it avoids the "evidentiary complexities and uncertainties" in determining the amount of any overcharge passed through the intermediary to the indirect purchaser. *Id.* at 730-33, 97 S.Ct. 2061. The Supreme Court expressly contemplated two exceptions to the indirect purchaser rule: (1) where the indirect purchaser acquired goods through a preexisting cost-plus contract and (2) "where the direct purchaser is owned or controlled by its customer." *Id.* at 736 & n. 16. *Illinois Brick* left unclear whether there might be exceptions for cases in which the amount of the overcharge that was passed on to a lower tier of purchasers could be determined simply and with mechanical precision, but thereafter, the Supreme Court held that even where the amount of overcharge passed on is clear, allowing indirect purchasers to pursue damages claims would be inconsistent with *Illinois Brick*, and the Court refused to create any new exception. *Kansas v. UtiliCorp United, Inc.*, 497 U.S. 199, 208, 110 S.Ct. 2807, 111 L.Ed.2d 169 (1990). Moreover, in *UtiliCorp United*, the Supreme Court cautioned lower federal courts against creating new exceptions to the *Illinois Brick* rule. *Id.* at 216, 110 S.Ct. 2807 ("The rationales underlying *Hanover Shoe* and *Illinois Brick* will not apply with equal force in all cases. We nonetheless believe ample justification ex-

ists for our stated decision not to carve out exceptions to the direct purchaser rule." (internal quotation marks omitted)).

Despite this admonition, several courts have recognized a "co-conspirator exception" to *Illinois Brick*. *See, e.g.*, *Paper Sys. Inc. v. Nippon Paper Indus.*, 281 F.3d 629, 631-32 (7th Cir.2002); *Lowell v. American Cyanamid Co.*, 177 F.3d 1228, 1231 (11th Cir.1999); *Campos v. Ticketmaster Corp.*, 140 F.3d 1166, 1171 (8th Cir.1998); *In re Brand Name Prescription Drugs*, 123 F.3d at 604-05; *Arizona v. Shamrock Foods Co.*, 729 F.2d 1208, 1211 (9th Cir.1984). Gravity asserts that these cases stand for the proposition that *Illinois Brick* is inapplicable when any conspiracy has been alleged, but we interpret these cases as standing for the more narrow proposition that *Illinois Brick* is inapplicable to a particular type of conspiracy – price-fixing conspiracies. *Cf. McCarthy v. Recordex Serv., Inc.*, 80 F.3d 842, 854-55 (3d Cir.1996) (refusing to adopt a co-conspirator exception where plaintiffs have not alleged that the intermediaries immediately upstream colluded to overcharge). Were we to adopt Gravity's broader interpretation, the *Illinois Brick* rule would be inverted solely based upon artful pleading. Such a result is contrary to *Illinois Brick* itself as well as the Supreme Court's clear directive in *UtiliCorp United* against crafting new exceptions to the *Illinois Brick* rule. Far more reasonable is the proposition that, to the extent a court were to recognize a co-conspirator exception to *Illinois Brick*, such an exception would be grounded on the damages theory underlying the alleged conspiracy. For example, the rationale for concluding that *Illinois Brick* does not apply to a price-fixing conspiracy is that no overcharge has been passed on to the consumer: When a dealer has illegally conspired with a manufacturer with respect to the price paid by a consumer, then "the consumer is the only party who has paid any overcharge." 2 Areeda & Hovenkamp ¶ 371h, at 264. We need not resolve whether we would recognize a co-conspirator exception to *Illinois Brick*'s indirect purchaser rule for a price-fixing conspiracy because no such

conspiracy has been alleged here. Instead, Gravity's compensatory damages claim is premised on an attempt to recover for Microsoft's illegal overcharge that allegedly was passed on to Gravity. Accordingly, Gravity's claim is materially indistinguishable from the claim under consideration in *Illinois Brick*, and its inclusion of a conspiracy allegation is insufficient to circumvent the *Illinois Brick* rule.

Nevertheless, Gravity argues that *Illinois Brick* ought not to control because the policy concerns underlying *Illinois Brick* are not implicated here. First, Gravity contends that there is no danger of duplicative recovery because the OEMs "apparently have elected not to sue Microsoft." (Appellant's Br. at 69.) The Supreme Court in *Illinois Brick*, however, "recognize[d] that direct purchasers sometimes may refrain from bringing a treble-damages suit for fear of disrupting relations with their suppliers." *Illinois Brick*, 431 U.S. at 746, 97 S.Ct. 2061. Yet, the majority concluded that "on balance . . . the legislative purpose in creating a group of private attorneys general to enforce anti-trust laws . . . is better served by holding direct purchasers to be injured to the full extent of the overcharge paid by them than by attempting to apportion the overcharge among all that may have absorbed part of it." *Id.* (internal quotation marks omitted).

Gravity also argues that its claims do not require the complex task of price-tracing because the consumers' damages are the difference between the "but-for" price that they would have paid for the Windows software absent the illegal conspiracy and the amount they actually paid for it. This argument misses the point, in that to calculate the "but-for" price, the court would be required to determine the over-charge, if any, for Microsoft's software that was passed on to consumers – the exact analysis that *Illinois Brick* forbids.

Finally, Gravity suggests that, to the extent there is any difficulty in apportioning damages, the court could avoid this difficulty by awarding 100% of the overcharge

to the consumer. Gravity does not explain, however, why consumers should be awarded a windfall. At bottom, Gravity's policy arguments are virtually identical to those raised by Justice Brennan in his *Illinois Brick* dissent. *Id.* at 748-65, 97 S.Ct. 2061 (Brennan, J., dissenting). Of course, they were considered and rejected by the majority in formulating the indirect purchaser rule, and we are not at liberty to reevaluate those policy choices here. Accordingly, we conclude that *Illinois Brick* bars Gravity's claims for compensatory damages for the alleged § 1 and § 2 violations.

V.

We conclude that Gravity's § 1 and § 2 claims fail as a matter of law and that, in any event, *Illinois Brick* bars Gravity's ability to recover compensatory damages. Thus, we affirm the judgment of the district court.

AFFIRMED.

GREGORY, Circuit Judge, dissenting.

I agree with the majority, *ante* at [8a-9a], that Gravity's § 1 claims need not meet the more rigorous standards of § 2 of the Sherman Act. However, I respectfully dissent. Whether or not Gravity would succeed on the merits, it has clearly stated claims under both § 1 and § 2 of the Sherman Act.

I.

The majority makes its first error when it rejects Gravity's allegations of a single conspiracy, relying on *Kotteakos v. United States*, 328 U.S. 750, 755, 66 S.Ct. 1239, 90 L.Ed. 1557 (1946). In *Kotteakos*, the Supreme Court rejected one articulation of a "rimless wheel" conspiracy. The conspiracy envisioned – and rejected – by *Kotteakos* states: "A rimless wheel conspiracy is one in which various defendants enter into separate agreements with a common defendant, but where the defendants have no connection with one another, other than the common defendant's involvement in each transaction." *Ante*, at [9a-

10a]. The majority says that because the *Kotteakos* Court rejected a variant of a "rimless wheel" conspiracy, we must too. The problem with that reasoning is that Gravity is *not* arguing that we should adopt the specific definition of conspiracy that was rejected in *Kotteakos*.

In *Kotteakos*, the underlying crime was conspiracy to obtain loans under the National Housing Act by false and fraudulent statements. The center of the conspiracy was a man named Brown, who was in the business of brokering fraudently obtained loans for his co-conspirator clients. 328 U.S. at 753, 66 S.Ct. 1239. All of the clients used Brown to obtain the loans, but each client's use of Brown's services was independent of every other client's use. *Id.* *Kotteakos* involved not one, but multiple conspiracies. Not only did Brown's co-conspirators have no express agreements among themselves, their participation was also in no way *dependent* on the participation of other users of Brown's services. The Court drew upon an analogy offered by the court of appeals to explain the point: "Thieves who dispose of their loot to a single receiver – a single 'fence' – do not by that fact alone become confederates: they may, but it takes more than knowledge that he is a 'fence' to make them such." *Id.* at 755, 66 S.Ct. 1239.

In contrast to *Kotteakos*, Gravity outlined the elements of a "rimless wheel" conspiracy as follows:

> (1) that there is an overall-unlawful plan or common design in existence;
>
> (2) that knowledge that others *must be involved* is inferable to each member because of his knowledge of the unlawful nature of the subject of the conspiracy[,] but knowledge on the part of each member of the exact scope of the operation or the number of people involved is not required; and
>
> (3) there must be a showing of each alleged member's participation.

Elder-Beerman Stores Corp. v. Federated Dep't Stores, Inc., 459 F.2d 138, 146-47 (6th Cir.1972) (emphasis

deleted and added); *Impro Prods., Inc. v. Herrick*, 715 F.2d 1267, 1279 (8th Cir.1983) (quoting *Elder-Beerman*). Whether we should adopt this test *in toto* I would not decide today, but I believe that this definition of a "rimless wheel" conspiracy is useful for purposes of this case, and is consistent with well-established interpretations of the Sherman Act.

The critical difference between the test Gravity urges, and the test *Kotteakos* rejected lies in the requirement "that knowledge that others must be involved is inferable to each member because of his knowledge *of the unlawful nature of the subject of the conspiracy*" (emphasis added). *Id.* Gravity has alleged that the nature of the conspiracy, by design and by necessity, was broader than any one agreement between Microsoft and an OEM, and that knowledge of that interdependent design was inferable to each member of the conspiracy. Regardless of whether any OEM desired the participation of other OEMs (and they conceivably might have), Gravity alleges that each OEM joined a conspiracy which it knew was, by its nature, broader than just itself and Microsoft.

These allegations are plainly sufficient to state a claim under the Sherman Act. The law has been clear that there need not be an express agreement between every conspirator in order for a single conspiracy to be formed. *Interstate Circuit, Inc. v. United States*, 306 U.S. 208, 227, 59 S.Ct. 467, 83 L.Ed. 610 (1939) ("[I]t is elementary that an unlawful conspiracy may be and often is formed without simultaneous action or agreement on the part of the conspirators"); *see also United States v. Masonite Corp.*, 316 U.S. 265, 275, 62 S.Ct. 1070, 86 L.Ed. 1461 (1942) ("Here, as in *Interstate Circuit*, . . . [i]t was enough that, knowing that concerted action was contemplated and invited, the distributors gave their adherence to the scheme and participated in it."); *United States v. Tillett*, 763 F.2d 628, 632 (4th Cir.1985) (stating that plaintiff must show that each alleged conspirator "participated in the conspiracy with knowledge of the essential nature of the plan.").

In *Interstate Circuit, Inc. v. United States*, film exhibitors suggested that film distributors insert clauses into their distribution contracts requiring minimum ticket prices for certain films. The distributors accepted the suggestion nearly unanimously. The Court held that an agreement among the distributors could be inferred:

> Each [distributor] was aware that all were in active competition and that without substantially unanimous action with respect to the restrictions . . . there was risk of a substantial loss of the business and good will of the . . . exhibitors, but that with it there was the prospect of increased profits.

306 U.S. at 222, 59 S.Ct. 467. Such is the case with the OEMs. It takes no stretch of logic to infer that the OEMs knew that Microsoft's plans contemplated the cooperation of other OEMs. It is the agreement to participate in this common plan that formed a single conspiracy. "Acceptance by competitors, without previous agreement, of an invitation to participate in a plan, the necessary consequence of which, if carried out, is restraint of interstate commerce, is sufficient to establish an unlawful conspiracy under the Sherman Act." *Interstate Circuit*, 306 U.S. at 227, 59 S.Ct. 467. Thus, I would find that the allegations are sufficient to state a claim.

II.

The majority next finds that Gravity has failed to allege "facts which, if proven true, would establish that the two conspiracies separately imposed unreasonable restraints of trade in interstate commerce." *Ante*, at [14a]. Even if I agreed that there were two conspiracies and not one alleged in this case, there is no question that Gravity's pleadings are more than adequate.

The majority requires far more from Gravity than is appropriate under notice pleading standards. Aside from a statement of jurisdiction and a demand for relief, Federal Rule of Civil Procedure 8(a) requires nothing more than "a short and plain statement of the claim showing that the pleader is entitled to relief[.]" 534 U.S. 506, 122

S.Ct. 992, 997, 152 L.Ed.2d 1. The elements for a claim of conspiracy to restrain trade in violation of § 1 of the Sherman Act are (1) concerted action that (2) unreasonably restrains trade. *Estate Constr. Co. v. Miller & Smith Holding Co.*, 14 F.3d 213, 220 (4th Cir.1994); *Oksanen v. Page Memorial Hosp.*, 945 F.2d 696, 702 (4th Cir.1991). According to the majority, Gravity has not adequately pled the second element, an unreasonable restraint of trade, because Gravity failed to plead the market shares of the OEMs. This is necessary, the majority says, because Gravity must prove the OEMs' individual market power in order to prove the conspiracy's market power. The conspiracy's market power, in turn, is required to prove the potential for anticompetitive effects, which is part of Gravity's burden to satisfy the "rule of reason."

The majority's pleading standard conflicts with the Supreme Court's recent pronouncement on federal pleading requirements. "[U]nder a notice pleading system, it is not appropriate to require a plaintiff to plead facts establishing a prima facie case." *Swierkiewicz v. Sorema, N.A.*, 534 U.S. 506, 122 S.Ct. 992, 997, 152 L.Ed.2d 1 (2002). "This simplified notice pleading standard relies on liberal discovery rules and summary judgment motions to define disputed facts and issues and to dispose of unmeritorious claims." *Id.* at 998. "Rule 8(a)'s simplified pleading standard applies to all civil actions, with certain exceptions." *Id.* Thus, the Supreme Court has made crystal clear, just this past term, that an evidentiary standard does not determine the adequacy of a complaint. *Swierkiewicz v. Sorema, N.A.*, 534 U.S. 506, 122 S.Ct. 992, 997, 152 L.Ed.2d 1 (2002). It is inappropriate, therefore, to require plaintiffs to plead facts going to that evidentiary standard in a complaint.

While I agree that liability in this case, in all likelihood, would be determined under the "rule of reason" standard, *see, e.g., Continental T.V., Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36, 97 S.Ct. 2549, 53 L.Ed.2d 568 (1977), it seems to me that the "rule of reason" is an evidentiary standard, not a pleading requirement. Courts ordinarily have to

undertake a factual inquiry before it is determined whether the "rule of reason" or *per se* rules apply. If *per se* rules apply, then anticompetitive effects do not matter. *See United States v. W.F. Brinkley & Son Constr. Co., Inc.*, 783 F.2d 1157, 1162, n. 10 (4th Cir.1986) (noting this circuit recognizes *per se* antitrust violations and, in doing so, there is no requirement of proof of anticompetitive results). The conduct is illegal regardless of proof of effects. *Id.*

Additional specificity regarding the OEMs' market power is not necessary. While anticompetitive effect is often proven through analysis of the relevant market definition and market power, it can also be proven through *actual* anticompetitive effects. *FTC v. Indiana Fed'n of Dentists*, 476 U.S. 447, 460-61, 106 S.Ct. 2009, 90 L.Ed.2d 445 (1986); VII P. Areeda, Antitrust Law § 1511, p. 429 (1986). The Supreme Court made clear that it is inappropriate to require a plaintiff to plead facts which he may not need to succeed on the merits of the claim. *Swierkiewicz*, 122 S.Ct. at 997 (holding that plaintiff need not plead facts establishing a prima facie case of employment discrimination, in part because it would be "incongruous to require a plaintiff, in order to survive a motion to dismiss, to plead more facts than he may ultimately need to prove to succeed on the merits if direct evidence of discrimination is discovered"). Gravity has pled actual anticompetitive effects. *See* Compl. ¶¶ 4, 59, 62-63, 68-69, 91-92, 95, 107, 115-117, 123-124, 150, 152, 154-156. Accordingly, the complaint should withstand a motion to dismiss.

To the extent that Gravity intends to rely on market power to demonstrate the likelihood of significant anticompetitive effects, the relevant issue is whether the *conspiracy* had market power in the software markets, not whether the defendant OEMs had market power in the PC hardware market. Gravity has adequately pled the conspiracy's market power. *See, e.g.*, Compl. ¶ 150 ("Microsoft and these named co-conspirators have the power to control prices or exclude competition in these

relevant markets and have committed overt acts in furtherance of their conspiracy to monopolize."); *id.* ¶ 152 ("[The OEMS] are Microsoft's three largest distributors in the relevant market for Microsoft operating software, and among Microsoft's very largest distributors in the relevant markets for the sale of personal computer word processing and spreadsheet software. As participants in these markets they have joined Microsoft in extensive licensing and other agreements with the purpose and effect of monopolizing and restraining trade in these relevant markets, and they have benefitted substantially from this common anticompetitive scheme.").

The Court finds Gravity's allegations of market power deficient, but only because it misunderstands Gravity's argument regarding market power. According to the majority, Gravity argued on appeal that Microsoft's monopoly is the only relevant factor in determining whether the conspiracy had the power to harm competition. This is not correct. Gravity has asserted that the district court was wrong to require it to plead that each OEM defendant had sufficient market power in the hardware market to cause the injury alleged, pointing out that the relevant market is software, and the relevant entity is the conspiracy (either a bilateral or single conspiracy). Appellant's Br. at 46, 48, 49; *id.* at 50 ("The district court erred in assessing only Compaq's or Dell's market power rather than the market power of the combinations between each of them and Microsoft."). It is clear that Gravity understands the importance of the OEMs, and the pleadings, read in the light most favorable to Gravity, do not suggest otherwise. *See also* Fed.R.Civ.P. 8(f) ("All pleadings shall be so construed as to do substantial justice.").

Setting aside any confusion regarding Gravity's argument, the majority has identified an important issue concerning market power. While Microsoft has a monopoly in the relevant software markets, if the conspiracy included only minor OEMs, then the conspiracy would presumably have no power to cause significant anticompetitive effects. *See ante*, at [21a] n. 20. The parties dispute whether this

should be treated as a liability issue or a causation issue, Appellants' Br. at 7; Appellees Compaq, Dell, and PB Electronics' Br. at 28, and the majority does not resolve the dispute, *ante* at [19a] n. 19. The heading under which the issue should go is ultimately irrelevant because the majority identifies only a single deficiency in Gravity's pleadings: failure to plead the defendant OEMs' market shares in the PC market. *Ante* at [23a]. Yet this is not enough to entitle the defendants to a dismissal.

The complaint identifies the OEMs involved, states that they are Microsoft's largest OEM distributors, identifies the asserted anticompetitive conduct, states that the conspiracy's anticompetitive conduct had significant anticompetitive effects, and identifies the effects. Moreover, Microsoft is an adjudicated monopolist, with clear market power in the relevant software markets, and the defendant OEMs are among the largest players in the PC hardware market. There is simply no conceivable argument from which one could conclude, based solely on a failure to plead market share, that the defendants are not on notice of the claims against them and the grounds on which they rest. *See Conley*, 355 U.S. at 48, 78 S.Ct. 99 ("The Federal Rules reject the approach that pleading is a game of skill in which one misstep by counsel may be decisive to the outcome and accept the principle that the purpose of pleading is to facilitate a proper decision on the merits."). The OEMs' specific market power in the PC market is, at best, a subsidiary fact.

The majority cites a number of cases involving pleading standards. *See ante* at [23a-27a]. None of those cases, however, support the holding in this case. For example, it is true that in *Advanced Health-Care Services, Inc. v. Radford Community Hospital*, 910 F.2d 139 (4th Cir. 1990), we stated that a plaintiff must "colorably state[ ] facts which, if proven, would entitle him to relief." *Id.* at 145 n. 8. But, in that case, we *reversed* the district court's dismissal of the complaint, acknowledging that "the Supreme Court has stated that 'dismissals prior to giving the plaintiff ample opportunity for discovery should be

granted very sparingly.' *Hospital Bldg. Co. v. Trustees of Rex Hosp.*, 425 U.S. 738, 747, 96 S.Ct. 1848, 48 L.Ed.2d 338 (1976)." *Id.* at 144. Lack of specificity in the complaint was not the concern of that case. This Court never suggested that a plaintiff must plead detailed facts supporting every subsidiary factual conclusion. To the contrary, we employed a decidedly permissive standard for judging the adequacy of the complaint. In *Estate Constr. Co. v. Miller & Smith Holding Co.*, 14 F.3d 213 (4th Cir. 1994), we confirm that a complaint must provide "sufficient facts so that each element of the alleged antitrust violation can be identified," *id.* at 222 (internal quotation and citation omitted); but we never suggested that detailed, underlying facts are required in the complaint. Rather, our concern was with overly vague factual allegations and mere legal conclusions unsupported by any facts.

The full Sherman Act allegations in that case read as follows:

> Providence combined and/or conspired with the Miller & Smith defendants, Gordon V. Smith, Calloway, Connor, Jack B. Conner Associates, Inc. and others to restrain trade unreasonably in the Washington, D.C. metropolitan area by combining and/or conspiring to deprive the Pattersons of The Property, cause The Property to be sold in foreclosure at a price that would leave the Pattersons with no assets, and otherwise to drive them and Estate Construction out of the real estate development business in the Washington, D.C. metropolitan area. The combination and/or conspiracy produced adverse, anticompetitive effects within the relevant product and geographic market. The objects and conduct of the combination and/or conspiracy were illegal.

14 F.3d at 221 n. 15. We held that a plaintiff must "provide, whenever possible, some details of the time, place and alleged effect of the conspiracy; it is not enough merely to state that a conspiracy has taken place." *Id.* at

221. Gravity's claims, in contrast, are replete with all manner of detail – fifty-eight pages of detail.[1] The defendants in this case know *exactly* what conduct is alleged to have violated the antitrust laws, which is all that Rule 8 requires. It is not for us to change the rules of civil procedure mid-stream. "A requirement of greater specificity for particular claims is a result that must be obtained by the process of amending the Federal Rules, and not by judicial interpretation." *Swierkiewicz*, 122 S.Ct. at 999.

III.

Finally, the majority holds that the direct purchaser rule of *Illinois Brick Co. v. Illinois*, 431 U.S. 720, 97 S.Ct. 2061, 52 L.Ed.2d 707 (1977), and *Hanover Shoe, Inc. v. United Shoe Machinery Corp.*, 392 U.S. 481, 88 S.Ct. 2224, 20 L.Ed.2d 1231 (1968), precludes recovery. I disagree, and would join the Seventh, Ninth, and Eleventh Circuits, each of which has held that it does not. *Paper Systems, Inc. v. Nippon Paper Indus. Co., Ltd.*, 281 F.3d 629 (7th Cir.2002); *Lowell v. American Cyanamid Co.*, 177 F.3d 1228, 1233 (11th Cir.1999) ("*Illinois Brick* simply does not apply where the complaint alleges a vertical conspiracy with no pass-on."); *In re Brand Name Prescription Drugs Antitrust Litig.*, 123 F.3d 599, 604 (7th Cir.1997) (Posner, C.J.) ("[A]ny indirect-purchaser defense would go by the board since the [plaintiffs] would then be direct purchasers from the conspirators."); *Arizona v. Shamrock Foods Co.*, 729 F.2d 1208, 1212-14 (9th Cir.1984); *Fontana Aviation, Inc. v. Cessna Aircraft Co.*, 617 F.2d 478, 481

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[1] The majority also parenthetically quotes *Mun. Utils. Bd. of Albertville v. Alabama Power Co.*, 934 F.2d 1493, 1501 (11th Cir.1991): "A plaintiff must plead sufficient facts so that each element of the alleged antitrust violation can be identified." *Ante* at [26a]. But the majority omits the important qualifier contained in the same paragraph: "However, the alleged facts need not be spelled out with exactitude, nor must recovery appear imminent." *Mun. Utils. Bd.*, 934 F.2d at 1501. Finally, *Car Carriers, Inc. v. Ford Motor Co.*, 745 F.2d 1101, 1106 (7th Cir.1984), stands for the unexceptional and well-worn proposition that a plaintiff must at least "outline or adumbrate" a violation of the Sherman Act, instead of relying on a bare legal conclusion. *Id.*

(7th Cir.1980); *see also* II Phillip E. Areeda et al., *Antitrust Law* ¶ 346h, at 369 (2d ed. 2000) ("Whether one adopts a co-conspirator exception or regards this situation as outside *Illinois Brick*'s domain, there is no tracing or apportionment to be done."); *cf. McCarthy v. Recordex Serv., Inc.*, 80 F.3d 842, 855 (3d Cir.1996) (noting exception but declining to apply it because the upstream suppliers were not joined as defendants); *In re Beef Antitrust Litig.*, 600 F.2d 1148, 1163 (5th Cir.1979) (same); *Jewish Hosp. Ass'n v. Stewart Mech. Enters.*, 628 F.2d 971, 977 (6th Cir.1980) (noting exception but declining to apply it because vertical conspiracy allegations failed).

The decision in *Hanover Shoe* was motivated by the Court's desire to maximize deterrence by allocating the right to sue to the most efficient enforcer of antitrust law. The rationale was that indirect purchasers have a comparatively small injury, and consequently less incentive to sue. *Hanover Shoe*, 392 U.S. at 494, 88 S.Ct. 2224; *Illinois Brick*, 431 U.S. at 745, 97 S.Ct. 2061. A passing-on defense would make litigation less effective for direct purchasers as well, given the reduction in recovery as well as the complexities of apportioning damages between direct and indirect purchasers. *Hanover Shoe*, 392 U.S. at 493, 88 S.Ct. 2224. *Illinois Brick* is the logical corollary to *Hanover Shoe*. In *Illinois Brick*, the Court denied "passed-on" damages to indirect purchasers of a manufacturer's goods. Because of *Hanover Shoe*, failure to deny recovery for such damages would lead to duplicative recovery. *Illinois Brick*, 431 U.S. at 730-31, 97 S.Ct. 2061. The two cases therefore ensure full recovery while maximizing deterrence and avoiding duplicative recovery.

Permitting plaintiffs such as Gravity to sue intermediaries that were part of a conspiracy to raise *retail* prices above a competitive level is consistent with *Hanover Shoe* and *Illinois Brick*. As Judge Easterbrook recently wrote for the Seventh Circuit: "The right to sue middlemen that joined the conspiracy is sometimes referred to as a co-conspirator 'exception' to *Illinois Brick*, but it would be better to recognize that *Hanover Shoe* and *Illinois Brick*

allocate to the first non-conspirator in the distribution chain the right to collect 100% of the damages." *Paper Sys.*, 281 F.3d at 631-32. This is the correct reading of *Hanover Shoe* and *Illinois Brick*. It maximizes deterrence by giving the right to sue to the plaintiff with the most incentive to sue. As for any lingering doubt over whether the conspiring intermediary is the best plaintiff, or concern regarding multiple recovery, the case law has rightly recognized the importance of joining the intermediary in the suit – a requirement which has been met in this case. *See, e.g., McCarthy*, 80 F.3d at 855; *In re Beef Antitrust Litig.*, 600 F.2d at 1163; *In re Midwest Milk Monopolization Litig.*, 730 F.2d 528, 531 (8th Cir.1984).

The majority rejects the cases that have unanimously recognized a direct purchaser's right to sue, saying that those cases dealt with price-fixing conspiracies. I think that this case presents a substantially identical situation. Gravity is not complaining about any overcharge paid by the OEMs to Microsoft. Rather, Gravity is complaining about the conspiracy's ultimate overcharge of the consumer. Gravity actually argues that the defendant OEMs received discounts on software purchased from Microsoft. In other words, Microsoft shared some of the monopoly profits with the OEMs. If one were to assume that Microsoft gave *all* its monopoly profits to the OEMs then there would be no pass-on. The OEMs would simply be overcharging consumers, like in a resale price maintenance scheme. How much of its monopoly profits Microsoft retained is merely a matter of how the conspirators allocated the fruits of their alleged illegality, and is not directly relevant to Gravity. The damages that Gravity is seeking to prove are the difference between the price consumers actually paid for the Windows software and the "but for" price.

Much of the difficulty in calculating the "but for" price will come from disaggregating the price of PC hardware from the Microsoft software. This difficulty, however, is not the concern of *Illinois Brick*. It can occur when there is no middleman. It would occur, for example, if Microsoft

built and sold its own brand of Windows-operated PC. Mere difficulty in measuring damages is not a reason to preclude recovery. *See Bigelow v. RKO Radio Pictures*, 327 U.S. 251, 265, 66 S.Ct. 574, 90 L.Ed. 652 (1946) ("[I]n cases where a wrongdoer has incorporated the subject of a plaintiff's patent or trademark in a single product to which the defendant had contributed other elements of value or utility . . . this Court has sustained recovery of the full amount of defendant's profits where his own wrongful action has made it impossible for the plaintiff to show in what proportions he and the defendant have contributed to the profits") (citations omitted); *J. Truett Payne Co. v. Chrysler Motors Corp.*, 451 U.S. 557, 566-67, 101 S.Ct. 1923, 68 L.Ed.2d 442 (1981) ("[I]t does not come with very good grace for the wrongdoer to insist upon specific and certain proof of the injury which has itself inflicted.") (quotation omitted).

Aside from the problem of disaggregation, calculating the "but for" price may involve determining elasticities of supply and demand – the complexity identified by *Illinois Brick* – but no more so than in any of the other cases in which middlemen conspired with manufacturers. And there will be no duplicative liability. Moreover, determining elasticities of supply and demand can complicate any attempt to measure damages – "it is not occasioned solely by the presence of intermediaries." *Paper Sys.*, 281 F.3d at 633. The real concern of *Hanover Shoe* and *Illinois Brick* is the complexity of measuring the pass-on of an *actual* overcharge, and its potential negative effect on deterrence and compensation, not the mere difficulties of determining what the price would have been in a competitive market.[2] The majority's rule is essentially a free pass to any conspiracy that can make the damage it inflicts

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[2] To the extent that the litigation subsequently revealed true *Illinois Brick* issues, such as if the defendant OEMs switched sides and sued Microsoft, *see Paper Sys.*, 281 F.3d at 632, I agree that *Illinois Brick* might then require dismissal of Gravity's claims.

difficult to pin down. Until now, that has never been the law.

The majority reasons that adopting Gravity's argument would lead plaintiffs to plead a conspiracy that did not exist in order to evade *Illinois Brick*. Yet, there are mechanisms, primarily Rule 11, to deal with the abusive and unethical conduct of litigants and lawyers. I find troubling the majority's unhesitating willingness to cut off compensation to *all* injured consumers based on hypothetical abuses of liberal pleading rules. The interests of consumers are far more weighty than the majority is willing to recognize. Moreover, the concern about "artful pleading" has nothing whatsoever to do with *Illinois Brick* and *Hanover Shoe*. The direct purchaser rule is designed to *encourage* and *incentivize* private enforcement of the antitrust laws, not immunize corporate wrongdoers from having to litigate antitrust claims.

IV.

The most unfortunate aspect of this case is that, to the extent Gravity's claims have merit, consumers will be left uncompensated. Even more, raising the procedural bar for consumers' claims may further stifle technological innovation. By giving comfort to those entrenched interests that seek to protect the status quo, today's decision increases the likelihood of future anticompetitive conduct. To those who would introduce disruptive technologies, this ruling creates a strong disincentive to innovate. Without innovation, we all lose. I respectfully dissent.

APPENDIX B

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MARYLAND

No. MDL 1332

IN RE MICROSOFT CORP. ANTITRUST LITIGATION

GRAVITY, INC., ET AL.,

v.

MICROSOFT CORP.

[January 12, 2001]

OPINION

MOTZ, District Judge.

This case is one of the sixty-four antitrust actions against Microsoft Corporation that have been consolidated by the Multi-District Litigation Panel. It is different from all of the others in that it names as defendants, in addition to Microsoft, three original equipment manufacturers ("OEMs"), Compaq Computer Corporation, Dell Computer Corporation, and PB Electronics, Inc. (formerly Packard Bell NEC). Plaintiffs, Gravity, Inc., and Mark H. Dickson, allege that the four defendants conspired with one another to restrain trade unreasonably and to maintain Microsoft's monopolies in various markets.[1]

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[1] To the extent one believes that the worth of an idea can be measured in part by the consistency with which it is advocated, it may be noted that plaintiffs' counsel in this action have not pursued their conspiracy theory in a case they have filed on behalf of other plaintiffs under the California antitrust statute, which forecloses any *Illinois*

Plaintiffs seek to represent two classes. One of the classes is composed of U.S. purchasers, between October 20, 1993, and the present, of Microsoft Windows or MS-DOS operating software installed and sold with personal computers compatible with Intel x86/Pentium architecture, purchased directly from one of the three OEM defendants. The other class consists of U.S. purchasers, between October 20, 1993, and the present, of Microsoft word processing software and/or Microsoft spreadsheet software installed and sold with personal computers compatible with Intel x86/Pentium architecture, purchased directly from one of the three OEM defendants. Gravity also asserts an individual claim against Microsoft alone for monopolization of case management and litigation support software.

Defendants have moved to dismiss all of the claims. The motion will be granted except for the individual claim asserted against Microsoft by Gravity.

I.

Plaintiffs' allegations against Microsoft in the class action claims are essentially the same as those made by the plaintiffs in the other MDL cases. Those allegations are summarized in Part I(A) of the companion opinion I am issuing today ("*MDL Microsoft I*"). I will not repeat them here. The additional allegations pertain to the asserted conspiratorial conduct of the three OEM defendants. According to plaintiffs, this conduct consisted primarily of those defendants entering into a variety of restrictive agreements with Microsoft, including per-processor licensing fees, long-term distribution contracts, the bundling of Microsoft operating system software with Internet Explorer to exclude browser and Java competition, and the bundling of Microsoft operating system software and ap-

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Brick defense. *Illinois Brick v. Illinois*, 431 U.S. 720, 97 S.Ct. 2061, 52 L.Ed.2d 707 (1977).

plication software.[2] (First Amended Complaint ("FAC") ¶ 61.) In addition, Microsoft and the three OEM defendants allegedly agreed not to alter the Windows 95 boot-up sequence, thereby giving Microsoft an unfair advantage over competing browser suppliers. (FAC ¶ 90.) The overall purpose and effect of the restrictive agreements between Microsoft and the OEM defendants is alleged to be the preservation of Microsoft's monopolies in the operating system software market and in the word processing and spreadsheet software markets. As a result, plaintiffs are alleged to have suffered injury by defendants' raising the prices plaintiffs have paid for Microsoft's operating system and application software above competitive levels and by defendants' "denying them competitive choice, including the benefits of software innovation." (FAC ¶ 58.)

The specific benefits that plaintiffs allege the OEM defendants received from conspiring unlawfully with Microsoft are: "(a) inducements offered by Microsoft to enter into anticompetitive agreements; (b) the co-conspirators' capacity to charge mark-ups on monopoly software prices secure in the knowledge they would not be undercut by rivals; (c) the co-conspirators' capacity to compel their customers to purchase operating and application software secure in the knowledge they would not be undercut by rivals; and (d) the co-conspirators' capacity to compel their customers to purchase more memory and other hardware than would be necessary or desirable under full and vigorous software competition." (FAC ¶ 3.)

II.

In the First Amended Complaint, plaintiffs allege two conspiracies, one in violation of section 1, and the other in violation of section 2, of the Sherman Act. 15 U.S.C. §§ 1

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[2] Plaintiffs allege that the OEM defendants and Microsoft entered into exclusive dealing distribution arrangements and employed other unspecified "practices to exclude horizontal competition for Microsoft's" operating system software. (FAC ¶¶ 61-62.) However, these arrangements and practices are entirely unspecified, and plaintiffs' conclusory averments are not supported by any underlying factual assertions.

& 2. However, as accurately noted by plaintiffs' counsel during oral argument, the two conspiracies "coalesce," because the alleged conspirators are accused of having only one goal, the perpetuation of Microsoft's monopolies. Thus, this is a case in which the alleged section 1 and section 2 conspiracies are entirely coterminous with one another. With the possible exception of the per-processor licensing fees and long-term distribution contracts that expired near the beginning of the class period, plaintiffs allege no actual or intended restraint of trade short of monopolization.[3]

Accordingly, the sufficiency of plaintiffs' allegations must be gauged by the elements of a section 2 claim. Otherwise, plaintiffs could circumvent the requirements of a conspiracy to monopolize claim, including the requirement that a defendant be shown to have acted with the specific intent to monopolize, simply by characterizing their claim as one arising under section 1, whose elements of proof are not as stringent.[4] Plaintiffs do not seriously

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[3] Defendants contend that any claims based upon the per-processor licensing fees and long-term distribution contracts would be barred by limitations. I need not decide that question since it is clear that those contracts terminated well before the end of the class period and thus could not themselves support the class claims that by their nature require conduct continuing throughout the class period.

[4] Of course, in most cases (where plaintiffs allege a restraint of trade that may or may not be sufficiently effective to threaten or result in monopolization), section 1 and section 2 conspiracy claims can be separately pursued without plaintiffs being required to plead and prove section 2 elements as part of their section 1 claims. The "threshold showing" in such cases for both the section 1 and section 2 claims are the same. *See, e.g., Weit v. Cont'l Ill. Nat'l Bank & Trust Co.*, 641 F.2d 457, 458 (7th Cir.1981) (addressing conspiracy charges pursued under both sections); *see also United States v. Griffith*, 334 U.S. 100, 106, 68 S.Ct. 941, 92 L.Ed. 1236 (1948) (exploring the relationship between section 1 and section 2 claims), *overruled on other grounds, Copperweld Corp. v. Independence Tube Corp.*, 467 U.S. 752, 763 n. 8, 104 S.Ct. 2731, 81 L.Ed.2d 628 (1984); *cf. Seagood Trading Corp. v. Jerrico, Inc.*, 924 F.2d 1555, 1573 (11th Cir.1991) (noting common "threshold showing" required by the two sections); *Todorov v. DCH Healthcare Auth.*, 921 F.2d 1438, 1460 n. 35 (11th Cir.1991) (same); *Wagner v. Magellan*

argue to the contrary. They contend, however, that since the issue of intent ultimately presents a question of fact, the specific intent element of their conspiracy claims cannot be challenged until summary judgment, when an evidentiary record has been established. I do not agree. In a case such as this, a plaintiff's "factual allegations must be specific enough to justify 'drag[ging] a defendant past the pleading threshold'. . . . The price of entry, even to discovery, is for the plaintiff to allege a *factual* predicate concrete enough to warrant further proceedings, which may be costly and burdensome." *DM Research, Inc. v. Coll. of Am. Pathologists*, 170 F.3d 53, 55 (1st Cir.1999) (citation omitted) (emphasis added); *Kramer v. Pollock-Krasner Found.*, 890 F.Supp. 250, 255-56 (S.D.N.Y.1995).

In the context of this case, what does "specific intent" mean? It signifies something more than willing, voluntary, and knowing participation in the illegal course of conduct that Microsoft is alleged to have pursued. It means participating in that course of conduct for the specific, shared purpose of maintaining Microsoft's monopolies. *SuperTurf, Inc. v. Monsanto Co.*, 660 F.2d 1275, 1283 (8th Cir.1981); *see also Northeastern Tel. Co. v. AT&T Co.*, 651 F.2d 76, 85 (2d Cir.1981) ("The essence of [conspiracy to monopolize] is an agreement entered into

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Health Servs. Inc., 121 F.Supp.2d 673, 679 & n. 1 (N.D.Ill.2000) (same). However, since the section 2 claim has a higher intent requirement than does the section 1 claim, plaintiffs might prevail on the latter claim while losing on the former. *Wagner*, 121 F.Supp.2d at 681 ("A conspiracy to monopolize under Section 2 is somewhat different from its Section 1 counterpart because of its heightened intent element."). In the present case, that is not so, given the nature of plaintiffs' allegations and the admittedly fierce competition in the market in which the OEM defendants compete. The section 1 and section 2 claims necessarily rise and fall together since the only unlawful intent alleged is the intent to preserve Microsoft's monopolies. *Cf.* 3A Phillip E. Areeda & Herbert Hovenkamp, *Antitrust Law* ¶ 810 (1996) ("[I]n those instances where power is a prerequisite to holding an agreement to be an unreasonable restraint of trade [under section 1] . . . it would make no sense to hold the same agreement offensive to § 2 without proof of power.").

with the specific intent of achieving monopoly . . . ."). Thus, it is not enough to establish a section 2 conspiracy that the OEM defendants, confronted with demands made upon them by Microsoft by virtue of its monopoly power, decided to accede to those demands in order to gain advantage over their rivals in the markets in which they competed. Rather, what plaintiffs must prove is that when confronted with Microsoft's demands, the OEM defendants stepped back and concluded that maintaining Microsoft's monopolies was a goal that they themselves desired to accomplish. That is an element of plaintiffs' case, and they are under an obligation to plead facts from which it can reasonably be inferred that the OEM defendants formulated that intent.

Defendants argue not only that plaintiffs have failed to meet that obligation, but also that the conspiracy they charge is inherently implausible. It would be irrational, defendants contend, for them, as purchasers, to seek to maintain monopolies that Microsoft, their supplier, possessed. *See TV Communications Network, Inc. v. Turner Network Television, Inc.*, 964 F.2d 1022, 1026-27 (10th Cir.1992); *Stephen Jay Photography, Ltd. v. Olan Mills, Inc.*, 903 F.2d 988, 994 (4th Cir.1990) ("[A]ppellants have articulated no motive the [defendants] might have to engage in such a conspiracy. Indeed, logically the converse is true because the [defendants] benefit when [suppliers] aggressively compete for contracts."); *Coastal Transfer Co. v. Toyota Motor Sales*, 833 F.2d 208, 211 (9th Cir.1987) ("[S]uch an intention . . . would have been illogical because a restriction on competition in the [given] market would have raised prices in a market in which [the defendant] purchased services."); *Car Carriers, Inc. v. Ford Motor Co.*, 745 F.2d 1101, 1109-10 (7th Cir.1984) ("[T]he plaintiffs are alleging, in essence, that [the defendant] conspired to injure itself."). Those monopolies enabled Microsoft to control the prices at which the OEM defendants had to buy operating system and application software for installation in the computers they manufactured. A rise in those prices would cut into the OEM defendants'

profits since those defendants sell their goods in an extremely competitive market. Citing such cases as *Spectators' Communication Network v. Colonial Country Club*, 231 F.3d 1005 (5th Cir.2000), plaintiffs counter that what may seem irrational in the abstract may not be so in fact, and that their allegations that the OEM defendants benefitted from their ready acquiescence to Microsoft's monopolistic demands make their charge of conspiracy plausible.[5]

The fallacy in plaintiffs' contention is that although plausibility is necessary for an antitrust conspiracy claim, it is not sufficient. *Cf.* 6 Phillip E. Areeda, *Antitrust Law* ¶ 1412g (1986). Plaintiffs have suggested motives that, at least in theory, might have led the OEM defendants to accept, willingly and voluntarily, the imposition of Microsoft's restrictive agreements. Plaintiffs have not, however, identified any facts to support their conclusory assertion that the OEM defendants acted with specific intent, i.e., that they decided that Microsoft's monopolies were in their own interest and something they affirmatively wanted to perpetuate. Based upon plaintiffs' allegations, it is at least as likely that the OEM defendants simply chose to make the best of a bad situation in order not to be undercut by their competitors.[6] In that regard,

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[5] As indicated earlier in the text, plaintiffs allege that these benefits included relatively favorable prices for Microsoft products, greater cooperation from Microsoft in product development, the protection of market positions by ensuring that Windows-based offerings would not be undercut by rivals offering computer hardware with lower-priced software or without pre-installed software, and the ability to sell more computer hardware because Microsoft's operating system software requires greater hardware capacity. It would appear that only the first two categories of benefits were uniquely bestowed upon the OEM defendants in return for their alleged ready acquiescence.

[6] Of course, the mere fact that a defendant is coerced into joining a conspiracy does not alone constitute a defense. *United States v. Paramount Pictures, Inc.*, 334 U.S. 131, 161, 68 S.Ct. 915, 92 L.Ed. 1260 (1948); *Spectators' Communication Network*, 231 F.3d at 1010-12 (listing cases). However, as I have stated, even willful and voluntary acceptance of restrictions imposed by a monopolist is not the equiva-

it is to be noted that plaintiffs allege that Microsoft imposed the same restrictive agreements upon all the OEMs with which it dealt. Thus, in accepting those restrictions, the OEM defendants are not alleged to have done anything different from any other OEM.

The only thing that plaintiffs contend distinguishes the OEM defendants from other OEMs is the alacrity with which they acquiesced in accepting those agreements to obtain relatively favorable prices from Microsoft for its products. But bargaining for better prices is perfectly normal commercial behavior, the type of behavior from which a court should be reluctant to infer conspiratorial conduct. *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 594, 106 S.Ct. 1348, 89 L.Ed.2d 538 (1986); *Zinser v. Rose*, 868 F.2d 938, 942 (7th Cir.1989). That is especially true since plaintiffs do not deny that the computer market in which the OEMs sell their products is fiercely competitive. *See Digital Equip. Corp. v. Uniq Digital Techs., Inc.*, 73 F.3d 756, 761 (7th Cir.1996) ("Computer manufacturers are vigorous rivals; . . . this is one of our economy's most competitive sectors."); *see also United States v. Microsoft Corp.*, 87 F.Supp.2d 30, 41 (D.D.C.2000) (noting the "very competitive PC market"); *United States v. Microsoft Corp.*, 84 F.Supp.2d 9, 24 at ¶ 54, 65 at ¶ 225 (D.D.C.1999) (same). No allegation is made that the OEM defendants, either individually or collectively, possessed sufficient market power to control the price of computers in any way. Therefore, if they did not negotiate for favorable prices with Microsoft, they ran the substantial risk of being undersold by their competitors.[7]

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lent of forming the specific intent to further the monopoly. It follows a fortiori that coerced acceptance of a monopolist's restriction does not constitute such intent. It is noteworthy that plaintiffs have expressly declined to take a position as to whether the OEM defendants were coerced into entering into Microsoft's restrictive agreements. (Gravity Pls.' Opp'n at 21-22.)

[7] An apparent paradox of plaintiffs' claims is that, at least in the short run, the OEMs' ability to obtain cheaper prices for software from

This leads to a related weakness in plaintiffs' claims against the OEM defendants. Although plaintiffs assert that those defendants were part of a single conspiracy to maintain Microsoft's monopolies, they make no allegation that the OEM defendants made any agreement among themselves. As alleged, this is a "spokes of the wheel" conspiracy with Microsoft at the hub but no rim discernible to the naked eye. The most that plaintiffs allege is that the OEM defendants acted in parallel, and consistently with the economic self-interest of each of them. This weakness would be fatal under the rule of *Mylan Laboratories, Inc. v. Akzo, N.V.*, 770 F.Supp. 1053, 1066 (D.Md.1991), which held that a "rimless wheel" antitrust conspiracy is not actionable.

Assuming that the *Mylan Laboratories* rule is too rigid to the extent that it requires allegation and proof of an actual or virtual "conspiratorial meeting" among competitors, at the least plaintiffs "must demonstrate that the defendants shared a 'unity of purpose or a common design and understanding, or a meeting of the minds' to engage in the conduct prohibited by the Sherman Act." *Impro Prods. Inc. v. Herrick*, 715 F.2d 1267, 1273 (8th Cir.1983), *citing Am. Tobacco Co. v. United States*, 328 U.S. 781, 810, 66 S.Ct. 1125, 90 L.Ed. 1575 (1946). Here, all that plaintiffs allege to meet this element is that the OEMs were generally aware that Microsoft was demanding similar restrictive agreements in all of their negotiations and that OEMs who acquiesced more quickly to Microsoft's demands were receiving more favorable terms. Again, this knowledge on the part of the OEMs would not establish that they "shared a unity of purpose" or that "their minds had met" to maintain Microsoft's monopolies. Likewise, the fact that, armed with that knowledge, the OEM defendants were each independently able to negotiate relatively favorable terms with Microsoft establishes no "common design and understanding" between them. It shows

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Microsoft presumably benefitted consumers, at least on price, since the OEMs were selling in a highly competitive market.

nothing more than that they acted competitively vis-a-vis one another. To hold them liable for doing so would run afoul of the "fundamental antitrust concept that the alleged sins of sellers should not be visited on buyers because of the risk of chilling competition." *Genetic Sys. Corp. v. Abbott Labs.*, 691 F.Supp. 407, 415 (D.D.C.1988).

III.

For these reasons, I find that plaintiffs have not stated any cognizable conspiracy claims. Therefore, I need not decide whether the co-conspirator exception to the *Illinois Brick* indirect purchaser rule adopted by many courts is properly applicable here. *Lowell v. Am. Cyanamid Co.*, 177 F.3d 1228, 1231 (11th Cir.1999); *In re Brand Name Prescription Drugs Antitrust Litig.*, 123 F.3d 599, 604-05 (7th Cir.1997); *McCarthy v. Recordex Serv., Inc.*, 80 F.3d 842, 855 (3d Cir.1996); *Arizona v. Shamrock Foods Co.*, 729 F.2d 1208, 1211-14 (9th Cir.1984); *Jewish Hosp. Ass'n v. Stewart Mech. Enters.*, 628 F.2d 971, 977 (6th Cir. 1980); *In re Beef Indus. Antitrust Litig.*, 600 F.2d 1148, 1163 (5th Cir.1979); *In re Mid-Atlantic Toyota Antitrust Litig.*, 516 F.Supp. 1287, 1295 (D.Md.1981). Without the conspiracy theory, plaintiffs' class claims against Microsoft fail for the same reasons as do the federal claims of the plaintiffs in the other MDL actions that I dismiss today in *MDL Microsoft I*.

However, Gravity's individual claim against Microsoft for monopolization of case management and litigation support software survives Microsoft's perfunctory motion to dismiss. Determination of whether Gravity's "monopoly-leveraging" claim is viable must await development of a factual record. *M & M Med. Supplies & Serv., Inc. v. Pleasant Valley Hosp., Inc.*, 981 F.2d 160, 168-69 (4th Cir.1992) (en banc); *Advanced Health-Care Servs., Inc. v. Radford Cmty. Hosp.*, 910 F.2d 139, 149 n. 17 (4th Cir.1990); *Advanced Health-Care Servs., Inc. v. Giles Mem'l Hosp.*, 846 F.Supp. 488, 496-97 (W.D.Va. 1994) (ruling against the existence of a monopoly-leveraging claim under section 2 on summary judgment).

I will enter an order implementing the rulings made in this opinion after conferring with counsel.

APPENDIX C

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MARYLAND

No. MDL 1332

IN RE MICROSOFT CORP. ANTITRUST LITIGATION

GRAVITY, INC., ET AL.,

v.

MICROSOFT CORP.

[September 28, 2001]

OPINION

MOTZ, Chief Judge.

Earlier this year, I dismissed counts I and II of the first amended complaint filed by Gravity, Inc., and Mark H. Dickson, against Microsoft Corporation and three original equipment manufacturers ("OEMs"), Compaq Computer Corporation, Dell Computer Corporation, and PB Electronics, Inc. *In re Microsoft Corp. Antitrust Litig.*, 127 F.Supp.2d 728 (D.Md.2001). These counts asserted class claims on behalf of consumers who had purchased computers from named OEMs on which Microsoft software products had been pre-installed. Plaintiffs now seek leave, pursuant to Federal Rule of Civil Procedure 15, to file a second amended complaint[1]. Although plaintiffs have recast some of their allegations in an attempt to address some of the points upon which my prior opinion

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[1] Plaintiffs have dropped PB Electronics as a defendant in the second amended complaint.

turned, they have not cured the fundamental defects in their claims. Accordingly, their motion for leave to amend will be denied on the ground of futility.

I.

The primary holding in my prior opinion had three parts: (1) plaintiffs' claims under section 1 of the Sherman Act "coalesced" with their claims under section 2 of the Act; (2) plaintiffs were therefore required to allege facts supporting the averment required by section 2 that the OEM defendants specifically intended to perpetuate Microsoft's monopolies; and (3) plaintiffs had failed to allege sufficient facts to meet this pleading requirement. I also noted that although plaintiffs asserted that the OEM defendants were part of a single conspiracy to maintain Microsoft's monopolies, they made no allegation that those defendants made any agreement among themselves, i.e., that the most plaintiffs had alleged was a "rimless" wheel conspiracy which, under the rule of *Mylan Labs., Inc. v. Akzo, N.V.*, 770 F.Supp. 1053, 1066 (D.Md.1991), was not actionable.

In an attempt to cure these perceived deficiencies, plaintiffs have added counts alleging a series of separate bilateral conspiracies – between Microsoft and Compaq alone and Microsoft and Dell alone – that are said to be in violation of section 1. Compaq and Dell are each alleged to have entered into these conspiracies either because they had the specific intent to maintain Microsoft's monopolies or because they were coerced by Microsoft to do so. Plaintiffs have also added in the second amended complaint tying claims based upon the bundling of Internet Explorer and Windows 95 or Windows 98.[2]

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[2] In addition, in the second amended complaint, plaintiffs allege that the per processor and long term license agreements between Microsoft and the OEM defendants remained in force after the signing of the July 15, 2001 consent decree between Microsoft and the Justice Department. This allegation is made in response to a limitations argument made by the OEM defendants. I do not find it necessary to address that argument or the efficacy of the amended allegation.

II.

Although plaintiffs now assert section 1 restraint of trade claims that allegedly are separate and distinct from one another and from plaintiffs' section 2 monopolization claims, the changes they have made in the second amended complaint are only cosmetic. This can be seen by scrutinizing the nature of the damages that plaintiffs assert. Plaintiffs do not claim any damages that might arise directly from any agreement between Microsoft and either Compaq or Dell alleged to be in restraint of trade, such as the cost to consumers who preferred Netscape as their browser and who therefore allegedly overpaid for their Windows licensing agreement since Internet Explorer was bundled with Windows 95 or Windows 98. Rather, plaintiffs assert that they were damaged by having to pay supracompetitive prices for Microsoft's operating software and applications software because defendants, by virtue of their exclusionary conduct, suppressed competition in the operating and software markets and in the middleware market, thereby stifling the development of other products that would have driven prices down.

Plaintiffs' damage theory necessarily assumes, insofar as their section 1 claims are concerned, that Compaq and Dell (either alone or together) had sufficient shares of the consumer market in which they sold their products that, but for the allegedly unlawful agreements into which they entered with Microsoft, competition in the relevant software markets would not have been suppressed and the development of alternative products would not have been stifled. But plaintiffs make no such allegation. Nor could they do so in light of their concessions that the consumer computer market is fiercely competitive and that Microsoft entered into exclusionary agreements with other OEMs that were the same or similar to the ones it made with Compaq and Dell about which they complain. Thus, under the allegations in the second amended complaint there is a lack of any causal nexus between the alleged section 1 conspiracies and the damages plaintiffs seek to recover.

In other words, in the final analysis, according to plaintiffs' allegations, Microsoft was calling the shots on an industry-wide basis. Therefore, Microsoft's agreements with Compaq and Dell alone could not have had the suppressive effects that plaintiffs allege. It may be assumed, as plaintiffs allege, that Microsoft entered into a series of multiple conspiracies for its own purpose of perpetuating its monopolies. If it did so, it violated both section 1 and section 2. However, that fact alone does not convert the aggregation of multiple conspiracies into a single overriding conspiracy, the purpose and effects of which can be attributed to the members of the alleged separate conspiracies other than Microsoft itself. Under black-letter conspiracy law, a conspirator is responsible only for acts undertaken in furtherance of the conspiracy of which he is a member. Here, the damages claimed by plaintiffs cannot be said to have been caused by any single section 1 conspiracy between Microsoft and either Compaq or Dell. They could only have been caused by a wide section 2 conspiracy of which Microsoft and numerous OEMs were members. Thus, the "coalescing" problem remains, and the second amended complaint – which alleges no new facts demonstrating that Compaq and Dell shared Microsoft's monopolistic goals – does not cure it.

III.

Defendants also renew the argument they made in their motion to dismiss the first amended complaint that plaintiffs' class claims are barred by the indirect purchaser rule of *Illinois Brick Co. v. Illinois*, 431 U.S. 720, 97 S.Ct. 2061, 52 L.Ed.2d 707 (1977). I declined to reach that argument in my earlier opinion, and I recognize that I need not do so here. However, I have concluded that the *Illinois Brick* rule does apply and that it is in the interest of the expeditious resolution of this litigation that I so declare.

Plaintiffs contend that they are not seeking "pass through" overcharges exacted by a monopolist from another innocent party – the type of damages to which

Illinois Brick applies – but rather damages that all of the defendants directly caused to plaintiffs by raising barriers to competition. Of course, there is no question that plaintiffs are seeking "pass through" overcharges. The very essence of their damage theory is that when they purchased computers from Compaq and Dell, they paid too much for their licenses to Microsoft software because Microsoft was able to sell inferior products at supracompetitive prices by suppressing competition in the relevant software markets.[3] Therefore, it is not the nature of their alleged damages but rather Compaq's and Dell's alleged lack of innocence that is the key to plaintiffs' argument. In effect, they are invoking what has been characterized as the "co-conspirator" exception to *Illinois Brick* recognized by many courts. *See Lowell v. American Cyanamid Co.*, 177 F.3d 1228, 1231 (11th Cir.1999), *State of Arizona v. Shamrock Foods Co.*, 729 F.2d 1208, 1211-12 (9th Cir. 1984), *Abrams v. Interco Inc.*, 1980 WL 1822, *2 (S.D.N.Y. 1980), *Reiter v. Sonotone Corp.*, 486 F.Supp. 115, 119 (D. Minn.1980), *In re Anthracite Coal Antitrust Litig.*, 1978 WL 1341, *3 (M.D.Pa.1978), *Florida Power Corp. v. Granlund*, 78 F.R.D. 441, 443-44 (M.D.Fla.1978), *Gas-A-Tron v. American Oil Co.*, 1977 WL 1519, *2 (D.Ariz.1977); *see also In re Mid-Atlantic Toyota Antitrust Litig.*, 516 F.Supp. 1287, 1295 (D.Md.1981) (acknowledging that numerous courts have recognized "at least the possibility" of a co-conspiracy exception).

According to plaintiffs, *Illinois Brick* does not apply since the two concerns that gave rise to its holding – the potential for double recovery and the complexities pre-

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[3] Plaintiffs seek to represent a series of classes who purchased computers sold to class members by Compaq or Dell on which Microsoft operating software or applications software had been installed. If they were not seeking "pass through" damages, there is no reason their proposed classes would be so limited. Instead, presumably they would seek to represent all persons who had allegedly been damaged by the alleged conspirators, whether or not they had purchased their computers from Compaq or Dell.

sented by price tracing – are absent.[4] Their first contention is not without force since their joinder of Compaq and Dell does appear to resolve the "double recovery" issue. Plaintiffs themselves could make only one recovery, and Compaq and Dell could assert cross-claims against Microsoft for contribution and indemnity. If they chose not to do so, presumably collateral estoppel would prevent them from doing so in any future action. Several courts have found these considerations regarding double recovery persuasive where the alleged co-conspirators have been joined or could have been joined as defendants. *See, e.g., McCarthy v. Recordex Service, Inc.*, 80 F.3d 842, 854-55 (3d Cir.1996) (noting obligation to fully join defendants in order for co-conspirator exception to apply), *In re Beef Indus. Antitrust Litigation*, 600 F.2d 1148, 1163 (5th Cir. 1979) (declining to apply co-conspirator exception, without deciding the merits of the exception, where alleged co-conspirators were not named as defendants), *In re Mid-Atlantic Toyota*, 516 F.Supp. at 1294-96 (discussing liability in context of price-fixing case where all alleged conspirators had been named as defendants).

It is less clear that plaintiffs' claims eliminate the complexities of price tracing. *Cf. Kansas v. UtiliCorp United, Inc.*, 497 U.S. 199, 213, 110 S.Ct. 2807, 111 L.Ed.2d 169 (1990) (noting that resolution of the multiple recovery issue still leaves issues of complexity). Microsoft software constituted only a small part of the many components of the computers sold by Compaq and Dell. Plaintiffs' claims assume not only that the prices that Microsoft was charging to the OEMs for licenses to its software were supra-competitive, but also that these overcharges were passed

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[4] Plaintiffs quarrel with the "exception" terminology, contending that the absence of these two concerns in a conspiracy case renders *Illinois Brick* inapplicable *ab initio*, rather than providing a basis for the creation of an exception to its holding. I recognize the logic of plaintiffs' argument but will refer in the text to the "co-conspirator exception" since that is the term that has become conventional in the case law. My conclusion remains the same whatever phraseology is used.

through dollar for dollar to the consumers to whom the OEMs sold their products. The fiercely competitive market in which the OEMs operated would seem to belie that assumption: presumably the market drove down the prices the OEMs could charge and may have caused them to absorb part of the Microsoft overcharges. Self-evidently, analysis of that issue would be complex.

Plaintiffs respond that this analysis is unnecessary since it must be assumed that, as culpable co-conspirators, Compaq and Dell passed through all of the Microsoft overcharges to their customers. Otherwise stated, according to plaintiffs, if Compaq and Dell were forced to absorb a portion of their component costs, the law establishes a presumption that they did so on component parts other than Microsoft products. Thus, according to plaintiffs, all they need prove is the extent of the Microsoft overcharges. But plaintiffs were injured only if they paid too much for the products they purchased, i.e., computers on which Microsoft software had been installed. Therefore, at the least they would have to present some evidence to demonstrate that the OEMs would have sold computers at even lower prices than those enforced by the fiercely competitive market and that the guilty OEMs' profits were greater than the amount of the Microsoft overcharges. This analysis too is self-evidently complex.

These complexities aside, I am persuaded that there is a more fundamental fallacy in plaintiffs' position. Their argument would provide a means for circumventing the *Illinois Brick* rule in any vertical conspiracy case in which a plaintiff could meet the relatively low pleading threshold of alleging that a distributor had been coerced into entering into a conspiracy with a powerful manufacturer to maintain the latter's monopoly. To open this door would be inconsistent with the teaching of *Illinois Brick* and its progeny that the *Illinois Brick* rule is intended to have broad force and effect and that departures from it must be narrow in scope. *See UtiliCorp*, 497 U.S. at 216-17, 110 S.Ct. 2807; *see also, e.g., In re Brand Name Prescription*

Drugs Antitrust Litig., 123 F.3d 599, 605 (7th Cir.1997) (explaining that "Utilicorp implies that the only exceptions to the Illinois Brick doctrine are those stated in Illinois Brick itself . . ."), *Jewish Hosp. Ass'n of Louisville, Ky., Inc. v. Stewart Mech. Enters.*, 628 F.2d 971, 975 (6th Cir.1980) (commenting on the "narrow scope of exemptions to the indirect-purchaser rule"). Although, as I have indicated, many courts have recognized a "co-conspirator exception" to the rule, the vast bulk of these cases have involved price-fixing, where the very purpose of the alleged conspiracy is to pass through an agreed upon overcharge to the indirect purchaser. *See, e.g., Lowell*, 177 F.3d at 1229, *Shamrock Foods*, 729 F.2d at 1210, *Abrams*, 1980 WL 1822 at *1, *In re Anthracite Coal*, 1978 WL 1341 at *1, *Gas-A-Tron*, 1977 WL 1519 at *1; *see also* 2 Phillip E. Areeda & Herbert Hovenkamp, Antitrust Law ¶ 371h (Rev. ed.1995) (discussing price-fixing cases that employ the co-conspirator exception). Here, plaintiffs' theory of conspiracy is far more nebulous and the alleged nexus between the conspirators' alleged wrongful conduct and the harm suffered by the plaintiffs is far more indirect. In my view, *Illinois Brick* therefore bars their claims.

A separate order denying plaintiffs' motion for leave to file a second amended complaint is being entered herewith.

APPENDIX D

UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

No. 01-2458

MARK H. DICKSON, *Plaintiff-Appellant*,
AND
CAREY D. EBERT, TRUSTEE IN BANKRUPTCY
FOR GRAVITY, INC., *Trustee-Appellant*,
AND
403 WEST LOOP 820 N, *Plaintiff*,

v.

MICROSOFT CORPORATION;
COMPAQ COMPUTER CORPORATION; DELL COMPUTER;
PACKARD BELL NEC, INC.,
Defendants-Appellees.

[December 19, 2002]

On Petition for Rehearing and Rehearing In Banc

The appellants filed a petition for rehearing and rehearing en banc.

Judge Gregory voted to grant panel rehearing. Judges Williams and Michael voted to deny.

No member of the Court requested a poll on the petition for rehearing en banc.

The Court denied the petition for rehearing and rehearing en banc.

APPENDIX E

Statutory Provisions

Section 1 of the Sherman Act, 15 U.S.C. § 1, provides:

§ 1. Trusts, etc., in restraint of trade illegal; penalty

Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal. Every person who shall make any contract or engage in any combination or conspiracy hereby declared to be illegal shall be deemed guilty of a felony, and, on conviction thereof, shall be punished by fine not exceeding $10,000,000 if a corporation, or, if any other person, $350,000, or by imprisonment not exceeding three years, or by both said punishments, in the discretion of the court.

Section 2 of the Sherman Act, 15 U.S.C. § 2, provides:

§ 2. Monopolizing trade a felony; penalty

Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a felony, and, on conviction thereof, shall be punished by fine not exceeding $10,000,000 if a corporation, or, if any other person, $350,000, or by imprisonment not exceeding three years, or by both said punishments, in the discretion of the court.

Supreme Court, U.S.
FILED
APR 7 2003
CLERK

No. 02-1305

IN THE

Supreme Court of the United States

OCTOBER TERM, 2002

CAREY D. EBERT, AS TRUSTEE IN BANKRUPTCY FOR GRAVITY, INC., and MARK H. DICKSON,

Petitioners,

—*v.*—

MICROSOFT CORPORATION, COMPAQ COMPUTER CORPORATION, DELL COMPUTER CORPORATION, and PB ELECTRONICS, INC. (F/K/A/ PACKARD BELL NEC, INC.),

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

MICROSOFT CORPORATION'S BRIEF IN OPPOSITION

Thomas W. Burt
Richard J. Wallis
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Counsel for Respondent Microsoft Corporation

April 7, 2003

Questions Presented

In *Illinois Brick Co.* v. *Illinois*, 431 U.S. 720 (1977), this Court held that indirect purchasers have no claim for damages under the federal antitrust laws, and suggested only two possible exceptions to that rule. Gravity concedes that it acquired Microsoft's software only by purchasing a personal computer ("PC") from a manufacturer that had preinstalled that software—*i.e.*, that it is an indirect purchaser of software—and that neither suggested exception to *Illinois Brick* applies here. Instead, Gravity asserts that because it alleged that manufacturers of the purchased PCs conspired to give Microsoft (their supplier) monopoly power in certain *software* markets, *Illinois Brick* is inapplicable.

The questions presented for review are:

1. Did the Fourth Circuit correctly affirm dismissal of Gravity's damages claims under the indirect-purchaser rule of *Illinois Brick*?

2. Did the Fourth Circuit correctly affirm dismissal of Gravity's antitrust conspiracy claims given its failure to allege harm to competition?*

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* As in the proceedings below, Microsoft primarily addresses herein the *Illinois Brick* issues, while the other respondents address in greater detail Gravity's failure to plead an actionable Sherman Act conspiracy claim.

Rule 29.6 Corporate Disclosure Statement

Microsoft Corporation has no corporate parents, and no publicly held company owns 10% or more of Microsoft Corporation's stock.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 2002

CAREY D. EBERT, as TRUSTEE in BANKRUPTCY for GRAVITY, INC., and MARK H. DICKSON,

Petitioners,

v.

MICROSOFT CORPORATION, COMPAQ COMPUTER CORPORATION, DELL COMPUTER CORPORATION, and PB ELECTRONICS, INC. (f/k/a/ PACKARD BELL NEC, INC.),

Respondents.

MICROSOFT CORPORATION'S BRIEF IN OPPOSITION

This Court should deny the petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the Fourth Circuit in this case. That court's application of *Illinois Brick* is entirely consistent with the decisions from the three other circuits to which Gravity points. Indeed, the Fourth Circuit carefully analyzed the decisions from those other circuit courts and properly concluded that they all involve a "narrow" situation—price fixing between the manufacturer and direct purchaser—that concededly is not at issue here. (App. 30a) There is no conflict among the circuits on the proper application of *Illinois Brick* to the facts of this action.

The Fourth Circuit's judgment is not only consistent with *Illinois Brick* but compelled by it. The petition for certiorari should be denied.

Statement of the Case

A. Background.

In 1998, the United States and certain States brought actions alleging that Microsoft had improperly maintained a monopoly in a market for operating-system software by engaging in certain conduct directed at competitors or potential competitors. The government actions never alleged that consumers were overcharged for Microsoft software. Subsequently, about 140 putative class actions were filed in state and federal courts around the country by private parties alleging that end-users had been overcharged for Microsoft software and seeking damages for those alleged overcharges. Most of these actions were filed in state courts invoking state laws that permit indirect purchasers to recover damages.

The Judicial Panel on Multidistrict Litigation transferred this and approximately 60 other federal-court actions against Microsoft to the District of Maryland. The JPML has also transferred to that district court a putative class action brought on behalf of those that purchased software directly from Microsoft for resale, including computer manufacturers (also called original equipment manufacturers or OEMs).

Of all these cases brought against Microsoft, this is the only one in which any plaintiff has sued any OEM alleging an antitrust "conspiracy" among OEMs and Microsoft. Indeed, the same lawyers who brought this action also filed—almost simultaneously—a nearly identical action in California state court under California state law (which permits indirect-purchaser actions) in which Microsoft is the sole defendant.

B. Gravity's Allegations.

Gravity concedes it did not purchase software or anything else from Microsoft. Instead, Gravity acquired Microsoft software by purchasing a PC on which an OEM had preinstalled Microsoft software. Thus, Gravity never directly

purchased software—the subject of the alleged conspiracy—from Microsoft or anyone else.

According to Gravity, the OEM defendants conspired with Microsoft to allow Microsoft to monopolize certain software markets and then to charge the OEM defendants—the direct purchasers of the software—monopoly prices. The OEMs then allegedly passed on the overcharges to Gravity in the form of higher prices for PCs. The three OEM defendants allegedly benefited from this peculiar scheme (which gave their supplier monopoly power over an important input) by obtaining more favorable treatment from Microsoft than other unidentified OEMs. Gravity never alleged that Microsoft and the OEM defendants conspired to fix prices of either software or PCs.

Gravity's petition fails to mention a key concession explicitly relied upon by both the district and circuit court. (App. 18a, 59a) In the proceedings below, Gravity conceded that PC prices are set in a "hyper-competitive" market. (C.A. App. 561, 555) There is no allegation that PCs (the product Gravity purchased) were the subject of any conspiracy.

C. The District Court's Decisions.

In January 2001, in the actions brought by end-users, the district court—applying *Illinois Brick*'s bright-line rule precluding indirect purchasers from recovering damages under federal antitrust law—dismissed the damages claims of indirect purchasers. *In re Microsoft Corp. Antitrust Litig.*, 127 F. Supp. 2d 702, 708-13 (D. Md. 2001). At the same time, the court dismissed under Fed. R. Civ. P. 12(b)(6) Gravity's conspiracy claims on the ground that Gravity had failed to allege that the OEM defendants had either the motive or power to enhance Microsoft's market position. (App. 46a) Though the parties had briefed the issue, the district court did not then reach the issue of whether *Illinois Brick* also barred Gravity's damages claims. (App. 55a)

In February 2001, Gravity sought leave to file an amended complaint under Fed. R. Civ. P. 15(a). The court denied that motion in September 2001 on grounds of futility, concluding that the proposed amendments did not cure Gravity's failure to allege a valid conspiracy claim. (App. 60a) In addition, the district court then concluded that, as an indirect purchaser of Microsoft software, Gravity's claims for damages were barred by *Illinois Brick*. (App. 64a)

D. The Court of Appeals' Decision.

The Fourth Circuit affirmed on both grounds in October 2002, in a 2-1 decision. With respect to whether a valid antitrust conspiracy had been alleged, the court held that Gravity had failed to allege that the conspiracy enhanced Microsoft's alleged market power in "ways that would not have obtained absent the agreement." (App. 21a) As to the district court's application of the indirect-purchaser rule, the Fourth Circuit concluded that the two primary rationales for the *Illinois Brick* rule—precluding "multiple, 'overlapping recoveries' against the original seller by direct and indirect purchasers" and avoiding "the 'evidentiary complexities and uncertainties' in determining the amount of any overcharge passed through the intermediary to the indirect purchaser"—applied with full force to Gravity's allegations here. (App. 29a (quoting *Illinois Brick*, 431 U.S. at 730, 732))

The Fourth Circuit also considered Gravity's contention that "*Illinois Brick* is inapplicable" because Gravity had purchased from an alleged co-conspirator. (App. 30a) After reviewing the decisions applying a so-called "co-conspirator" exception, however, the court concluded that those decisions all involved "price-fixing conspiracies," and it rejected Gravity's argument that the exception should be expanded beyond that "narrow" circumstance. (App. 30a) Otherwise, even "to the extent a court were to recognize a co-conspirator exception," the "*Illinois Brick* rule would be inverted solely based upon artful pleading." (App. 30a)

In November 2002, Gravity petitioned for rehearing and rehearing en banc. Both were denied on December 19, 2002. No judge requested a poll on the petition for rehearing en banc. (App. 65a)

Reasons For Denying the Petition

I.

Illinois Brick Bars Gravity's Damages Claims.

Illinois Brick involved an action brought by the State of Illinois against concrete block manufacturers that allegedly conspired to fix the price of concrete blocks. The manufacturers sold their concrete blocks to contractors, who incorporated the blocks into buildings purchased by Illinois. The manufacturers allegedly overcharged the contractors who, in turn, "passed on" the overcharge to Illinois. This Court rejected Illinois's claims and set forth the bright-line rule that only direct purchasers—those who purchased the product that was the subject of the alleged anticompetitive conduct directly from the alleged antitrust violator—can recover damages under federal antitrust law.

As the Fourth Circuit observed, Gravity's claims are "materially indistinguishable from the claim under consideration in *Illinois Brick*." (App. 31a) Gravity's claim that it paid too much for a PC containing software for which an OEM was allegedly overcharged is no different from Illinois's claim that it paid too much for buildings containing blocks for which a contractor was allegedly overcharged.

Despite this Court's admonition that "even assuming that any economic assumptions underlying the *Illinois Brick* rule might be disproved in a specific case, we think it an unwarranted and counterproductive exercise to litigate a series of exceptions," *Kansas* v. *UtiliCorp United Inc.*, 497 U.S. 199, 217 (1990), some courts have held that *Illinois Brick* does not apply where indirect purchasers allege an illegal vertical conspiracy whose object was to fix the price

of the product purchased by plaintiff. As the Fourth Circuit noted, this "co-conspirator" exception has never been applied by this Court, and it conflicts with this Court's observation in *UtiliCorp* that further exceptions to *Illinois Brick* "would undermine the rule." 497 U.S. at 216. Indeed, the dramatically expanded version of the co-conspirator exception urged by Gravity would swallow the rule whole.

Most importantly, as the Fourth Circuit recognized, the "co-conspirator" exception, even if it exists, is not at issue in this action. The decisions applying the exception have all arisen in the "narrow" situation where a plaintiff purchases a product whose price was set by a "price-fixing conspiracy." (App. 30a) This is because there is no need to engage in a pass-through analysis where the conspiracy's object was "the very price paid by the consumer." 2 PHILLIP E. AREEDA ET AL., ANTITRUST LAW ¶ 346h, at 369 (2d ed. 2000).[1]

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[1] The very cases relied upon by Gravity (i) demonstrate that this so-called exception is limited to price-fixing conspiracies and (ii) expose Gravity's false claim that the Fourth Circuit's application of *Illinois Brick* "conflicts with precedent from three circuits." (Pet. at 21 (capitalization omitted)) *See Paper Sys. Inc.* v. *Nippon Paper Indus. Co.*, 281 F.3d 629, 631 (7th Cir. 2002) ("conspir[ed] to . . . raise price"); *Lowell* v. *Am. Cyanamid Co.*, 177 F.3d 1228, 1229 (11th Cir. 1999) ("vertical price-fixing conspiracy"); *In re Brand Name Prescription Drugs Antitrust Litig.*, 123 F.3d 599, 606 (7th Cir. 1997) ("price-fixing conspiracy"); *Arizona* v. *Shamrock Foods Co.*, 729 F.2d 1208, 1210 (9th Cir. 1984) ("wholesale price-fixing conspiracy").

In a further attempt to invent a conflict among circuits, Gravity incorrectly asserts that the Seventh Circuit has applied the co-conspirator exception to a conspiracy that did not involve price-fixing. (Pet. at 22) In *Fontana Aviation, Inc.* v. *Cessna Aircraft Co.*, 617 F.2d 478, 481 (7th Cir. 1980), the court found *Illinois Brick* inapplicable because plaintiff, as a *competitor* of the alleged antitrust violator, pleaded "competitive injury which destroyed its . . . business." The Third Circuit has noted this distinction as well. *See Link* v. *Mercedes-Benz of N. Am., Inc.*, 788 F.2d 918, 931 n.11 (3d Cir. 1986) (*Fontana* concerns competitive injuries "distinct from a passed on overcharge").

But Gravity has not alleged that Microsoft and the OEM defendants conspired to fix the price of either software or PCs. Indeed, it conceded that prices for PCs—the only product Gravity alleges to have purchased—are set in a highly competitive market. Gravity's failure to allege a conspiracy to set the resale price of PCs makes the "co-conspirator" exception inapplicable. Accordingly, the Fourth Circuit's decision that Gravity's damages claims are barred falls squarely within this Court's holding in *Illinois Brick*.

In the end, Gravity's petition implicitly recognizes the absence of a genuine conflict among the circuits and devotes the majority of its discussion of the Fourth Circuit's *Illinois Brick* holding to broad policy attacks against the application of the indirect-purchaser rule. (Pet. at 23-28) Echoing the circuit court dissent's assertion that "*Illinois Brick* might . . . require dismissal of Gravity's claims" if the defendant OEMs "switched sides and sued Microsoft" (App. 44a n.2), Gravity asserts that the indirect-purchaser rule should not be applied here because OEMs have not sued Microsoft. (Pet. at 28) This is incorrect—an alleged class of OEMs is present in one of the pending cases in the trial court—but also irrelevant.

This Court rejected Gravity's argument in *Illinois Brick* itself. While expressly acknowledging that direct purchasers "sometimes may refrain from bringing a treble-damages suit for fear of disrupting relations with their suppliers," the Court nonetheless concluded that the deterrence goals of the antitrust laws were best served by concentrating the right of recovery on direct purchasers:

> [O]n balance, and until there are clear directions from Congress to the contrary, we conclude that the legislative purpose in creating a group of "'private attorneys general'" to enforce the antitrust laws under § 4 is better served by holding direct purchasers to be injured to the full extent of the overcharge paid by

> them than by attempting to apportion the overcharge among all that may have absorbed a part of it.

431 U.S. at 746 (citation omitted).

As the Fourth Circuit recognized, Gravity's policy arguments are "virtually identical" to those raised in Justice Brennan's *Illinois Brick* dissent. (App. 32a)[2]

II.

Gravity Has Failed to State a Cognizable Antitrust Conspiracy Claim.

Finally, as discussed more fully in the OEM defendants' brief, the Fourth Circuit correctly concluded that Gravity's conspiracy allegations, forced into the complaint in an attempt to evade *Illinois Brick*, fail to state a claim upon which relief can be granted. Gravity's assertion that the Fourth Circuit improperly applied a heightened pleading standard to dismiss Gravity's claims is wrong. An antitrust plaintiff must make allegations that, taken as true, demonstrate harm to competition. *See, e.g., NYNEX Corp.* v. *Discon, Inc.*, 525 U.S. 128, 140 (1998) (complaint that fails to allege "harm to the competitive process" subject to dismissal). Because Gravity conceded that the market for PCs was "'fiercely competitive,'" the Fourth Circuit properly concluded that Gravity had failed to plead facts showing that Microsoft's agreements with the OEM defendants "are capable of causing any substantial harm to competition." (App. 18a)

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[2] This is also not a case where the direct purchasers (OEMs) are owned or controlled by the alleged antitrust violator. *See Freeman* v. *San Diego Ass'n of Realtors*, No. 01-56199, 2003 WL 931834, at *6 (9th Cir. Mar. 10, 2003) (*Illinois Brick* inapplicable to price-fixing conspiracy where direct purchaser was "own[ed]" by antitrust violators); 2 AREEDA ET AL., ANTITRUST LAW ¶ 346f, at 367 (courts may allow indirect-purchaser recovery when "direct purchasers [are] owned or controlled by the *violator*").

Finally, although it expressed disagreement with the Sixth and Eighth Circuits' application of this Court's precedent in the course of addressing Gravity's conspiracy claims, the Fourth Circuit expressly noted that its holding was "unaffected" by that disagreement. (App. 11a n.13) Just as the Fourth Circuit's application of *Illinois Brick* involves no genuine conflict, no conflict justifying a grant of certiorari exists regarding the Fourth Circuit's conspiracy holding either.

Conclusion

The Court should deny the petition for a writ of certiorari.

Respectfully submitted,

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IN THE

Supreme Court of the United States

CAREY D. EBERT, TRUSTEE FOR GRAVITY, INC., AND MARK H. DICKSON,
Petitioners,

v.

MICROSOFT CORPORATION, COMPAQ COMPUTER CORPORATION, DELL COMPUTER CORPORATION, AND PB ELECTRONICS, INC.
Respondents.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Fourth Circuit

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RULE 29.6 STATEMENT

Pursuant to Rule 29.6 of the Rules of this Court, respondents Dell Computer Corporation, Compaq Computer Corporation and PB Electronics, Inc. state as follows:

Dell Computer Corporation has no corporate parents, and no publicly held company owns 10 percent or more of Dell Computer Corporation's stock.

Compaq Computer Corporation is wholly owned by Hewlett-Packard Company, a publicly traded company. No publicly held company owns more than 10 percent of Hewlett-Packard's stock.

As of March 20, 2003, NEC Corporation of Japan is the corporate parent of PB Electronics, Inc. and owns a majority of the stock of PB Electronics. Approximately 12 percent of the stock of PB Electronics is owned by subsidiaries of Group Bull of France.

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STATEMENT

This case is one of over 140 consumer class actions filed in the wake of the government's monopolization case against Microsoft Corporation. But it is the only case in which three original equipment manufacturers ("OEMs") — Respondents Dell, Compaq and PB Electronics (formerly known as Packard Bell NEC) — were named as alleged co-conspirators with Microsoft. Because these OEMs, like their many competitors making personal computers ("PCs"), obtained essential operating system software from Microsoft for installation on their products, they have been identified in other cases as being among the victims of Microsoft's monopolization. Yet Petitioners claimed that the three OEMs are wrongdoers that agreed with Microsoft to promote an anti-competitive scheme designed to insure that Microsoft would continue to be able to extract monopoly profits as the supplier of an input needed by all OEMs.

The only conduct of the Respondent OEMs that is alleged to have been anti-competitive was their acceptance of restrictions in software license agreements that Petitioners acknowledge were also accepted by every one of their OEM competitors. Petitioners claimed that those restrictions indirectly assisted Microsoft in preserving its monopoly over operating system software; that monopoly, in turn, was alleged to have given Microsoft a monopoly position in applications software. But Petitioners never alleged that the license agreement provisions at issue were *per se* illegal or that Dell, Compaq, and PB possessed a sufficient share of the PC market that their agreements alone — individually or collectively — could have affected competition in the software market at all. Instead, they relied on the purported impact that *industry-wide* acceptance of those licensing terms had on Microsoft's ability to maintain and promote its

alleged monopoly. The Fourth Circuit correctly rejected Petitioners' effort to hold three OEMs liable, as co-conspirators with Microsoft, for the license agreements of all the OEMs and a whole range of additional conduct by Microsoft that did not involve the OEMs at all.

In any event, Petitioners' novel conspiracy claims also constituted an improper attempt to sidestep the direct purchaser requirement that this Court established in *Illinois Brick Co. v. Illinois*, 431 U.S. 720 (1977). That rule was implicated here because Petitioners did not purchase anything directly from Microsoft. Their theory was that they were injured when the OEMs paid an allegedly inflated price to license Microsoft software and some or all of that surcharge was passed through to Petitioners as part of what they paid for PCs. Petitioners sought recognition of a broad "co-conspirator" exception to *Illinois Brick*, claiming that, merely because they were direct purchasers from one of the alleged conspirators, *Illinois Brick* did not apply. But any such exception, the Fourth Circuit correctly concluded, has been limited to cases involving allegations of price-fixing — which Petitioners do not allege here.

Government and Consumer Class Action Antitrust Claims Filed Against Microsoft

In 1998, the federal government and nineteen states filed antitrust complaints against Microsoft in the United States District Court for the District of Columbia. *See United States v. Microsoft Corp. ("Microsoft II")*, 253 F.3d 34, 45-48 (D.C. Cir. 2001), *cert. denied*, 534 U.S. 952 (2001). In that case, the governmental plaintiffs successfully argued that Microsoft used its license agreements to impose restrictions on all OEMs, such as preventing them from removing Internet Explorer icons from their PCs and modifying the

initial desktop boot-up sequence. *Microsoft II*, 253 F.3d at 60-63. Their theory was that Microsoft's imposition of these restrictions upon OEMs had the direct effect of discouraging use of the Netscape Internet browser and the indirect, long-term effect of protecting Microsoft's operating system monopoly in violation of section 2 of the Sherman Act. Because installing Windows on PCs was a commercial necessity for the OEMs, *United States v. Microsoft Corp.*, 84 F. Supp. 2d 9, 24, ¶¶ 54-55 (D.D.C. 1999), the Respondent OEMs, like all their competitors, accepted these restrictions even though they "impose[d] significant costs upon the OEMs," "prevented" OEMs from diversifying their products, and caused "dissatisfaction" among OEMs. *Microsoft II*, 253 F.3d at 62. [1]

United States v. Microsoft led to a long series of consumer class actions, sixty of which the multidistrict litigation panel consolidated in the United States District Court for the District of Maryland. *See In re Microsoft Corp. Antitrust Litigation*, 127 F. Supp. 2d 702, 704 (D. Md. 2001). This led to the filing of a new consolidated class action complaint on behalf of PC consumers against Microsoft alone, alleging that Microsoft violated federal antitrust laws by engaging in exclusionary, predatory, and/or anti-competitive acts. The "consolidated plaintiffs" sought both injunctive relief and damages for alleged overcharges on certain Microsoft software. The Maryland district court

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[1] A substantial portion of the conduct challenged in *United States v. Microsoft* did not involve the OEMs — *i.e.*, Microsoft's dealings with Netscape and its arrangements with Internet service and content providers. Nonetheless, those aspects of the Government's case were included in Petitioners' complaint and alleged to be part of the over-arching conspiracy for which Petitioners seek to hold each Respondent OEM fully liable.

dismissed their federal damages claims under *Illinois Brick* because consumers are not "direct purchasers" from Microsoft. *See id.* at 708-13. Some pendent state-law damages claims on behalf of consumers survived, and more recently the same consolidated counsel have filed a separate class action on behalf of direct purchaser OEMs.

Various consumer class actions are also pending against Microsoft in state courts under state antitrust laws. The largest was filed in California on behalf of a class of consumers who purchased PCs with Microsoft operating system, word-processing, and spreadsheet software.[2] *See Microsoft I-V Cases,* No. CJP-00-04106 (Cal. Super. Ct.); *see also Elkins v. Microsoft Corp.*, 817 A.2d 9 (Vt. 2002); *Howe v. Microsoft Corp.*, 656 N.W.2d 285 (N.D. 2003); *In re South Dakota Microsoft Antitrust Litigation,* 657 N.W.2d 668 (S.D. 2003); *In re Florida Microsoft Antitrust Litigation*, No. 99-27340, 2002 WL 31423620, at *3, ¶ 9 (Fla. Cir. Ct. Aug. 26, 2002) (listing additional class actions in other states).

Petitioners are the only plaintiffs in *any* of these cases who have sought to hold OEMs liable as co-conspirators with Microsoft. In essence, Petitioners alleged that the three OEM Respondents, admittedly vigorous competitors in the sale of personal computers, entered into a conspiracy with Microsoft to preserve Microsoft's alleged monopolies in the sale of operating system, word processing, and spreadsheet software in violation of Sherman Act (15 U.S.C.) §§ 1 & 2. Petitioners did not allege that the OEMs develop or manufacture software in the relevant markets. Nor did they

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[2] Because California does not follow *Illinois Brick*, the consumers could seek damages from Microsoft even though they were not direct purchasers.

allege that Microsoft and the OEM Respondents agreed to set prices for software or PCs, or that the OEMs ever agreed to obtain software exclusively from Microsoft. Pet. App. 3a. Instead, Petitioners argued that Microsoft's ability to impose the challenged restrictions on the OEM Respondents and the rest of the OEMs in the PC market promoted Microsoft's monopoly share in the licensing of operating system, word processing, and spreadsheet software, which allowed Microsoft to charge OEMs monopoly prices for that software. Petitioners further claimed that the OEMs passed on some or all of those excess prices when they loaded the software on PCs sold to consumers.

The sole facts alleged to support the claimed conspiracies were the license agreements between Microsoft and the Respondent OEMs. But Petitioners admitted that *all* OEMs, not just the three defendants, agreed to the same restrictions in their license agreements. Pet. App. 18a. They did not dispute that the Respondent OEMs independently negotiated their respective license agreements with Microsoft, and did not allege that the OEMs even knew the specific terms contained in the confidential agreements accepted by other members of the purported conspiracy. Instead, Petitioners distinguished the Respondents merely as having allegedly accepted Microsoft's licensing terms with greater alacrity than other OEMs, in exchange for discounted prices and other benefits. *See id.*

Petitioners also conceded that the PC market in which the OEMs operate is "fiercely competitive." Pet. App. 17a. They did not allege that the Respondent OEMs — combined or individually — have enough market power in the PC market to foreclose efforts by competing software suppliers to obtain access to that market. *Id.*

District Court Proceedings

The U.S. District Court for the District of Maryland (Motz, J.) dismissed Petitioners' first amended complaint on January 12, 2001. It held that Petitioners failed to allege "any cognizable conspiracy." Pet. App. 55a. That decision rested on several related deficiencies. First, Petitioners had failed to allege a sufficient basis for a finding that the OEMs acted with a specific intent to preserve Microsoft's market share — which is a requirement for a section 2 conspiracy to monopolize and which the district court also believed should be required when the same type of conspiracy is asserted as a violation of section 1. *Id.* at 48a-51a. Second, Petitioners had failed to allege that the OEM defendants had sufficient "market power" to affect competition. *Id.* at 53a. Third, Petitioners' allegations did not provide a basis for concluding that the OEMs formed a single conspiracy with Microsoft and one another, rather than merely acting "in parallel." *Id.* at 54a. The district court initially declined to reach the issue of whether *Illinois Brick* also barred Petitioners' claims. *Id.*

Petitioners sought leave to file a second amended complaint, in which they alleged, in the alternative, two separate, bilateral conspiracies between Dell and Microsoft and Compaq and Microsoft. (Petitioners did not name PB as a defendant in this second amended complaint.) The factual allegations were otherwise virtually identical to those in the first amended complaint and suffered from the same legal deficiencies; in particular, Petitioners again failed to allege that Dell or Compaq possessed market power in the PC market. Moreover, Petitioners' primary additional allegation — namely, that the conspiracies were "coerced" — had been previously considered and rejected by the district court. Pet. App. 52a n.6.

Finding that Petitioners' proposed changes were "only cosmetic," Pet. App. 59a, the court denied Petitioners' motion for leave to amend "on the ground of futility." *Id.* at 58a. It again relied on the fact that Petitioners had not alleged that Dell or Compaq had the necessary market power to suppress competition. *Id.*; *see also United States v. Microsoft Corp.*, 87 F. Supp. 2d 30, 51-54 (D.D.C. 2000) (dismissing the government's section 1 exclusive dealing claims relating to Microsoft and Compaq on the ground that any such arrangement did not foreclose access to a sufficient portion of the OEM market).[3]

The district court also concluded that *Illinois Brick*'s indirect purchaser rule bars Petitioners' damages claims. Pet. App. 60a-64a. Petitioners' overcharge theory falls squarely within the *Illinois Brick* paradigm and any price-tracing analysis based thereon is "self-evidently complex." *Id.* at 63a. In addition, it found a "more fundamental fallacy in plaintiffs' position" — namely, that Petitioners' argument "would provide a means for circumventing the *Illinois Brick* rule in any vertical conspiracy case in which a plaintiff could meet the relatively low pleading threshold of alleging that a distributor had been coerced into entering into a conspiracy with a powerful manufacturer to maintain the latter's monopoly." *Id.*

The Fourth Circuit's Affirmance

The Fourth Circuit affirmed the district court's ruling, by a vote of 2-1. The majority opinion discussed the law

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[3] The district court also concluded that Petitioners had again failed to include sufficient allegations that Dell or Compaq entered into contracts with Microsoft with specific intent to assist Microsoft in carrying out its alleged monopolistic goals. Pet. App. 59a-60a.

governing "hub and spoke" conspiracies and concluded that the single, four-party conspiracy first alleged by Petitioners was deficient because they failed to allege the requisite "rim" to connect the OEM Respondents as members of a common scheme. *See* Pet. App. 9a-11a. The court also noted that Petitioners had not argued that there was a sufficient "overlap of key actors, methods, and goals" to form a single conspiracy under the standards applied in criminal conspiracy cases. *Id.* at 10a n.12.

The court then held that Petitioners' bilateral and multilateral conspiracy claims were properly dismissed for the additional reason that Petitioners made no claim that the defendant OEMs had enough market power to injure competition. Pet. App. 11a n.13. Because Petitioners did not allege that the challenged license restrictions constituted a *per se* violation of the antitrust laws, the license agreements were subject to "the full rule of reason analysis." *Id.* at 14a. Accordingly, Petitioners' claims were deficient as a matter of law unless the challenged conduct has an "anti-competitive effect." *Id.* at 14a-15a. Because Gravity conceded that the PC market is "fiercely competitive" and that neither Compaq nor Dell has power in that market, *id.* at 17a, and further failed to allege any facts regarding Compaq and Dell's market share, the court concluded that Petitioners would be "unable, as a matter of law, to demonstrate that Microsoft's agreements with Compaq and Dell, when considered individually, are capable of causing any substantial harm to competition." *Id.* at 18a.

Finally, the Fourth Circuit agreed with the district court that the *Illinois Brick* doctrine barred Petitioners' monetary claims. *Id.* at 27a-32a. The court reviewed the decisions of other circuits applying a "co-conspirator" exception to the *Illinois Brick* rule, and determined that any such exception

would be limited to price-fixing conspiracies like those present in the cases reviewed. *Id.* at 30a. In those cases, no "pass through" problem exists, because the conspirators have set a price that the end-user pays. *Id.* Petitioners did not allege that the OEMs and Microsoft collusively set an anti-competitive price, but instead sought to recover damages for an alleged Microsoft overcharge that may have been passed on by OEMs to consumers. Accordingly, the "pass-through" problems identified in *Illinois Brick* remain, and it would not be appropriate to apply a "co-conspirator" exception to the *Illinois Brick* rule.

REASONS FOR DENYING THE PETITION

Petitioners offer no persuasive reason why the Court should review any of the three questions presented. First, Petitioners' claim that the court below imposed a heightened pleading standard is incorrect and is simply an effort to paper over a glaring flaw in their antitrust theory. Second, although the Fourth Circuit expressed some disagreement with language in two older cases from other circuits involving "hub and spoke" conspiracies, there is no true circuit conflict and this case provides a poor vehicle for exploring the limits of conspiracy law. Finally, the Fourth Circuit's ruling on the *Illinois Brick* issue is fully consistent with this Court's analysis and does not conflict with any decision of another circuit. *Illinois Brick* bars an indirect purchaser suit seeking damages based on higher prices passed through by manufacturers paying monopoly prices to their component supplier.

I. THE FOURTH CIRCUIT'S CONCLUSION THAT PETITIONERS FAILED TO ALLEGE ONE OF THE NECESSARY ELEMENTS OF THEIR ANTITRUST CLAIM IS CONSISTENT WITH THIS COURT'S PRECEDENT AND FEDERAL NOTICE PLEADING RULES.

Petitioners' assertion that the panel majority erroneously imposed a "heightened pleading" standard, and thereby contravened this Court's precedent regarding notice pleading, distorts both the Fourth Circuit's opinion and the pleading standards of the Federal Rules of Civil Procedure. The Fourth Circuit properly recognized that Petitioners' claims, founded as they are on the rule of reason, required an assertion that the conduct of the alleged conspirators caused an injury to competition in the relevant markets. At the pleading stage, particularly given that Petitioners conceded that the PC market was "highly competitive," Petitioners were required to address this essential element in more than conclusory fashion. They needed to allege that the three Respondent OEMs had a sufficient market share, or market power, in the PC market such that their acceptance of various specified restrictions in their license agreements with Microsoft could have substantially affected the ability of software companies to distribute their software through the OEM channel. Petitioners' failure to do so, despite multiple opportunities in the district court, renders all of the conspiracy theories articulated in the complaints defective, even under minimal notice pleading standards.

As the panel majority discussed in detail, the essence of Petitioners' claim is that the license agreements between Microsoft and the defendant OEMs caused the OEMs to favor Microsoft products in various ways, thereby reducing demand for, and/or access to, products developed by

alternative suppliers of operating system software, browser software and applications software. *See* Pet. App. 2a-5a. Petitioners do not contend that the OEMs' conduct is *per se* illegal under section 1. *See State Oil Co. v. Khan*, 522 U.S. 3, 10 (1997) (describing practices with "such predictable and pernicious anti-competitive effect, and such limited potential for procompetitive benefit, that they are deemed unlawful per se"); *Atlantic Richfield Co. v. USA Petroleum Co.*, 495 U.S. 328, 342 (1990). Accordingly, their antitrust claim is legally cognizable only if the alleged co-conspirators had sufficient market share and market power that *their* agreement to the licensing restrictions, by itself, would substantially affect the power of software companies to obtain access to the market for licensing software to OEMs. *See, e.g.*, *NYNEX Corp. v. Discon, Inc.*, 525 U.S. 128, 135 (1998) (concluding that plaintiffs bringing group boycott claim must allege harm to competition); *Eastman Kodak Co. v. Image Technical Servs., Inc.*, 504 U.S. 451, 464 (1992); *Board of Trade of the City of Chicago v. United States*, 246 U.S. 231, 238 (1918). But Petitioners never made that claim. To the contrary, they admitted that the OEM marketplace is "fiercely competitive" with a multitude of competitors. Pet. App. 17a.[4]

Thus, Petitioners' argument has nothing to do with pleading standards and everything to do with the scope of potential liability under the Sherman Act. Their real claim is breathtaking: it is that each Respondent OEM became a co-

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[4] *See also Microsoft II*, 253 F.3d at 61 (describing personal computer market as "highly competitive"); *Digital Equip. Corp. v. UNIQ Digital Techs. Inc.*, 73 F.3d 756, 761 (7th Cir. 1996) (same). In fact, Petitioners acknowledged that one of the Respondent OEMs, PB Electronics, exited the PC business and ceased operation as of December 1999.

conspirator with Microsoft when it accepted the restrictions on license agreements that Microsoft demanded, *and thereby became liable for everything Microsoft did industry-wide*, exercising its market power in the *software* market. *See* Pet. at 16-17 (arguing that Microsoft's power in the software market sufficed to establish the anti-competitive effects caused by the alleged conspiracies).[5] The logic of their position would mean that any of the multitude of OEMs, no matter how small, could also be subject to massive treble-damage liability — since all concededly accepted the same restrictions in their license agreements.

There is no reason to review the Fourth Circuit's rejection of that radical position. The conclusion of the court below that "it could not consider the cumulative harm of Microsoft's agreements with all OEMs," Pet. App. 22a, was well grounded in antitrust doctrine. Indeed, rather than attempting to show why it would make sense to hold each customer of a monopolist liable for everything that the monopolist does in relation to third parties, Petitioners simply attempt to avoid the issue by claiming that the Fourth

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[5]Gravity argues that because Microsoft has monopoly power in the software markets, the alleged conspiracy had sufficient market power to impact that market. *See* Pet. at 16. But the alleged injury to Microsoft's competitors stems from their purported inability to distribute their software through the OEM channel, and Gravity's theory of competitive harm is thus one of foreclosure from the PC market. Microsoft does not even participate in that market. Thus, the alleged conspiracy could only have an anti-competitive effect if the Respondent OEMs individually and/or collectively have sufficient control of the computer market that their license agreements alone could have foreclosed access by would-be software suppliers. Petitioners have never alleged that to be true, nor could they.

Circuit erred in applying new pleading standards. That is simply not true.

To the contrary, even in our system of notice pleading, Petitioners had an obligation to provide a "short and plain statement of the claim showing that the pleader is *entitled to relief*." Fed. R. Civ. P. 8(a) (emphasis added). Nothing in *Swierkiewicz v. Sorema N.A.*, 534 U.S. 506 (2002), altered that rule. One of the required elements of Petitioners' case is a showing that the license agreements of the Respondent OEMs could have affected competition by significantly barring access to the PC market by competing software suppliers. They failed to allege any mechanism by which the conduct of three OEMs, by itself, could have produced that result. They did not go beyond merely conclusory allegations on this key point, and thus failed to offer a statement showing their entitlement to relief.

Nor is there anything in *Zenith Radio Corp. v. Hazeltine Research, Inc.*, 395 U.S. 100 (1969), *see* Pet. at 18-19, that conflicts with the Fourth Circuit's ruling. While *Zenith* held that a conspiracy need only be a "material cause of the injury," 395 U.S. at 114 n.9, the Fourth Circuit correctly held that "[w]ithout an allegation of market share or market power," Petitioners still have failed to state a claim entitling Petitioners to any relief. Pet. App. 19a n.19. *Zenith Radio* in no way justifies holding the Respondent OEMs liable for anti-competitive effects that arose, if at all, only because the entire OEM industry agreed to the same restrictions.

Petitioners do attempt to locate some language in their complaints that differentiates the *Respondent* OEMs (although they deliberately confuse Hewlett-Packard with PB's predecessor, Packard Bell) from all of their competitors, attributing some special significance to the

dealings of Microsoft with those three customers. They point to allegations that Microsoft gave Compaq, Dell and PB (but not PB's predecessor, Packard Bell) discounts and other benefits. Pet. at 18. But those alleged facts, without some identification of a mechanism by which these three companies individually or collectively could affect competition by accepting restrictions on their use of software licensed by Microsoft, do not establish anti-competitive effects. At most, they show that the Respondent OEMs cut the best deal possible while accepting — as all of their competitors ultimately did as well — the restrictions that Microsoft demanded of everyone. Indeed, given the competitive nature of the PC market, if the OEMs "did not negotiate for favorable prices with Microsoft, they ran the substantial risk of being undersold by their competitors." Pet. App. 53a.[6]

Petitioners also argue that they should have been allowed to get past the pleading stage and look in discovery for evidence of actual anti-competitive effects in the marketplace. Pet. at 17-18. But that is just another way of repeating Petitioners' fallacious argument that the Respondent OEMs could properly be held liable for

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[6] Petitioners' additional allegation that the OEM Respondents were "among the largest players in the PC hardware market," Pet. App. 39a, does not cure their failure to articulate a basis for causing injury to competition. Even assuming that such a general statement could support an inference of anti-competitive effects in some hypothetical case, Petitioners' acknowledgement that the PC market is highly competitive prevents the statement from serving that purpose here. In such a market, with dozens of significant competitors and hundreds of participants, *see Digital Equipment Corp.*, 73 F.3d at 761, even the 8 or 9 "largest" players may not cumulatively possess a sufficient market share to cause harm to competition. Pet. App. 21a n.20.

everything Microsoft ever did. Discovery certainly would not provide any basis for separating out market effects caused by Microsoft's dealings with the *Respondent* OEMs, distinct from the effects of its consistent dealings with the entire industry.

Finally, Petitioners' claim that consumers will suffer if this kind of conspiracy case is not allowed rings false given the multitude of suits pending against Microsoft alone. If anything, it is Petitioners' theory that risks harm to consumers and the competitive process, because subjecting companies to antitrust liability for conduct like that alleged here would make it impossible for companies to enter into any commercial contract with a dominant or monopolist supplier of an essential input without facing draconian antitrust liability. And inferring membership in an anti-competitive conspiracy from a company's ability to obtain lower prices or other favorable terms from a manufacturer would seriously deter the companies from bargaining for better prices, thereby injuring consumers. *See* Pet. App. 53a n.7 (noting that the alleged discounts the OEMs received would cause lower prices and thereby *benefit* consumers); *see also Atlantic Richfield*, 495 U.S. at 340 (noting that "[l]ow prices benefit consumers regardless of how those prices are set"). Companies like the Respondent OEMs would be forced to choose between two options: (1) refuse to distribute the monopolist's products notwithstanding consumer demand for those products, or (2) face mammoth antitrust claims. Neither result would benefit consumers.

II. THIS CASE IS NOT AN APPROPRIATE VEHICLE FOR EXPLORING THE REQUIREMENTS FOR "HUB AND SPOKE" ANTITRUST CONSPIRACIES.

Petitioners also ask the Court to review the Fourth Circuit's handling of their "hub and spoke" conspiracy theory. The Court should decline that invitation. Petitioners' critiques of the Fourth Circuit on this issue are largely academic, since they would not affect the outcome, and are in any event misplaced.

The essence of Petitioners' single conspiracy claim was the allegation that each Respondent OEM accepted restrictive provisions in its license agreements with Microsoft, that Microsoft had anti-competitive reasons for demanding those provisions, and that the Respondent OEMs received some benefits for acquiescing to Microsoft's demands.[7] *See* Pet. at 12. Thus, Microsoft was allegedly the "hub" of the purported conspiracy, and its agreements with each OEM created the conspiracy's "spokes." Petitioners argue that these allegations are sufficient to support their conspiracy claim because the OEMs need not have met or agreed with one another to further the conspiracy, and that the Fourth Circuit's rejection of this "hub and spoke" conspiracy theory conflicts with the Sixth and Eighth Circuits' interpretation of this Court's conspiracy precedent in *Impro Products, Inc. v. Herrick*, 715 F.2d 1267 (8th Cir. 1983), and *Elder-Beerman Stores Corp. v. Federated*

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[7] Although Petitioners' characterization of their conspiracy claim suggests that the Respondent OEMs knew of Microsoft's anti-competitive intentions, and were aware that Microsoft likely obtained other OEMs' consent to the disputed licensing agreement terms, the complaint contains no such allegations of knowledge.

Department Stores, Inc., 459 F.2d 138, 146 (6th Cir. 1972). *See* Pet. at 12-16.

It is true that the Fourth Circuit expressed reservations about the Sixth and Eighth Circuits' decisions suggesting that they might allow some "hub and spoke" conspiracy claims. But there is no actual circuit conflict. Both *Impro* and *Elder-Beerman rejected* the hub and spoke claims at issue in those cases, applying reasoning that would be equally applicable here.

Indeed, the district court in this case itself applied the very test from *Impro Products* that Petitioners prefer, and it determined that Petitioners' allegations were not sufficient to establish a "hub and spoke" conspiracy claim under that test. As the district court persuasively reasoned:

> [A]t the least plaintiffs "must demonstrate that the defendants shared a 'unity of purpose or a common design and understanding, or a meeting of the minds' to engage in the conduct prohibited by the Sherman Act." *Impro Prods. Inc. v. Herrick*, 715 F.2d 1267, 1273 (8th Cir. 1982). Here, all that plaintiffs allege to meet this element is that the OEMs were generally aware that Microsoft was demanding similar restrictive agreements in all of their negotiations and that OEMs who acquiesced more quickly to Microsoft's demands were receiving more favorable terms. Again, this knowledge on the part of the OEMs would not establish that they "shared a unity of purpose" or that "their minds had met" to maintain Microsoft's monopolies. Likewise, the fact that, armed with that knowledge, the OEM defendants were each independently able to negotiate relatively favorable terms with Microsoft establishes no

> "common design and understanding" between them. It shows nothing more than that they acted competitively vis-a-vis one another.

Pet. App. 54a-55a. Accordingly, there is no reason for this Court to intervene to resolve the disagreement between the Fourth Circuit and the Sixth and Eighth Circuits over the exact standards that apply. *See Klehr v. A.O. Smith Corp.*, 521 U.S. 179, 192 (1997) (declining to resolve circuit disagreement where Petitioners' claim would fail even under the most lenient circuit's approach); *see generally Michigan v. Long*, 463 U.S. 1032, 1071 (1983) ("If it is not apparent that our views would affect the outcome of a particular case, we cannot presume to interfere.").

That Petitioners' claim would be subject to dismissal — regardless of whether "hub and spoke" arrangements may sometimes constitute actionable antitrust conspiracies — makes perfect sense. In any conspiracy case, the plaintiff must show that the defendants each made a "conscious commitment" to an unlawful scheme. *Monsanto Co. v. Spray-Rite Serv. Corp.*, 465 U.S. 752, 764 (1984). Especially in a hub and spoke context, that requirement should be understood to limit conspiracy claims to situations where each "spoke" had reason to know that its actions were unlawful. It is one thing to allow a hub and spoke claim in a case involving *per se* illegal price fixing, and quite another to do so here where the OEMs were accused of agreeing to restrictions on their operations that were not inherently problematic and were only claimed to have had long-term and indirect anti-competitive effects caused by the collective conduct of all OEMs.

If allegations like Petitioners' were enough to establish a single conspiracy, all companies operating in a competitive

market, seeking to purchase a commercially necessary input from a source with monopoly power, would expose themselves to staggering liability just by purchasing that input on the only terms available. Indeed as noted above, under Petitioners' theory, *all* OEMs in the industry would be guilty of entering into a conspiracy with Microsoft and all their competitors, simply because they accepted the licensing restrictions. As the district court concluded, to allow such a conspiracy claim "would run afoul of the 'fundamental antitrust concept that the alleged sins of sellers should not be visited on buyers because of the risk of chilling competition,'" Pet. App. 55a, and is directly contrary to the recognition of both courts and commentators that ordinary commercial transactions do not become actionable antitrust violations merely because a company conducts those transactions with an alleged monopolist. *See, e.g.*, *In re Beef Indus. Antitrust Litig.*, 600 F.2d 1148, 1161 (5th Cir. 1979); *49er Chevrolet, Inc. v. General Motors Corp.*, 803 F.2d 1463, 1467 (9th Cir. 1986); 6 Phillip E. Areeda & Herbert Hovenkamp, *Antitrust Law* ¶ 1408b (2d ed. 2003).

Finally, the fact that this case was dismissed at the pleading stage, and the resulting lack of factual development regarding any alleged conspiracies, provide an additional basis for denying certiorari. The lack of factual information would impede the Court's ability to establish and apply rules regarding the scope of any "hub and spoke" conspiracy theories that may be recognized under antitrust law. The Court could articulate broad principles of law, but would be unable to apply those principles to the specifics of this alleged conspiracy. Such an analysis would provide little guidance for lower courts, and the precedential value of such an opinion would be limited. *See generally Klehr*, 521 U.S. at 192-93 (declining to resolve circuit disagreement where

facts of case "do not force focused argument" about the issue for which Petitioners sought review). A case that has advanced beyond the pleading and discovery stage would therefore be a far more appropriate vehicle for exploring the viability of "hub and spoke" antitrust conspiracy claims. *See generally Joseph E. Seagram & Sons, Inc. v. Hostetter*, 384 U.S. 35, 43 (1966) (deferring review of dispute concerning alleged discriminatory effects that were "largely matters of conjecture" to a future case that "clearly presents" the issue).

III. THE JUDGMENT BELOW DOES NOT CONFLICT WITH PRECEDENT FROM OTHER CIRCUITS AND IS CONSISTENT WITH THIS COURT'S INSTRUCTIONS ON THE *ILLINOIS BRICK* DOCTRINE

In their complaints, Petitioners asserted that the OEM "conspiracy" with Microsoft — whether multi-lateral or bi-lateral — caused antitrust injury by raising the prices they paid to the OEMs due to a pass through of excess charges paid by the OEMs to Microsoft. *See* Pet. App. 31a. That alleged injury was not claimed to be caused by a resale price maintenance scheme, nor by any horizontal price fixing by the OEM Respondents. Rather, the injury was allegedly the result of a vertical conspiracy by which OEMs agreed to maintain the monopoly power of Microsoft, their supplier of a component integrated by OEMs into computer products, resulting in payment of higher prices for that component. That kind of antitrust theory, the Fourth Circuit correctly concluded, is "materially indistinguishable from the claim under consideration in *Illinois Brick*." *Id.*

The opinion below fully considered precedent from other circuit courts of appeals recognizing a "co-conspirator exception" to *Illinois Brick* for a price-fixing conspiracy.

The Fourth Circuit determined that those cases were simply not relevant, because no price-fixing conspiracy was alleged by Petitioners. Pet. App. 30a-31a. Further, the court concluded that the *Illinois Brick* doctrine applied here because there was a danger of duplicative recovery and the Gravity complaint required the "complex task of price-tracing … the exact analysis that *Illinois Brick* forbids." *Id.* at 31a-32a. These conclusions were both correct and fully consistent with this Court's previous instruction that lower courts should not "'carve out exceptions to the [direct purchaser] rule.'" *Kansas v. UtiliCorp United, Inc.*, 497 U.S. 199, 216 (1990) (quoting *Illinois Brick*, 431 U.S. at 744) (internal quotation marks & citation omitted).

A. The Judgment Does Not Conflict With Other Circuits' Precedent.

Petitioners assert that the Seventh, Ninth and Eleventh Circuits have each held that *Illinois Brick* does not preclude claims against vertical co-conspirators, citing *Paper Systems, Inc. v. Nippon Paper Industries Co.*, 281 F.3d 629, 631 (7th Cir. 2002); *Arizona v. Shamrock Foods Co.*, 729 F.2d 1208 (9th Cir. 1984); and *Lowell v. American Cyanamid Co.*, 177 F.3d 1228 (11th Cir. 1999). Pet. at 21-22. But the Fourth Circuit properly interpreted these opinions as standing only for the proposition that "*Illinois Brick* is inapplicable to a particular type of conspiracy — price-fixing conspiracies." Pet. App. 30a. The majority observed that it need not resolve whether the Fourth Circuit would recognize a similar co-conspirator exception to *Illinois Brick* for price fixing conspiracies because no such conspiracy was alleged by Petitioners. *Id.* at 30a-31a.

There is thus no conflict among the circuits shown here. Rather, the Court's opinion below properly construed the

precedent and distinguished Petitioners' case from those at issue in the earlier cases. *Lowell* and *Shamrock* are resale price maintenance conspiracy cases, where a supplier dictates to downstream distributors prices at which the product will be sold. *Lowell,* 177 F.3d at 1228; *Shamrock,* 729 F.2d at 1211. Both opinions distinguish resale price fixing cases from "pass-on" cases which remain fully subject to the *Illinois Brick* rule. *Lowell*, 177 F.3d at 1230 & n.4; *Shamrock*, 729 F.2d at 1212-14.

Nippon Paper involved a horizontal agreement among paper manufacturers to fix prices. Some of the manufacturers did not sell to plaintiffs but, instead, relied exclusively on trading firms to distribute their products. These trading firms were enlisted to join the horizontal price fixing conspiracy by agreeing to sell at the price set by the five manufacturers. 281 F.3d at 631-32. The Seventh Circuit decision in *Nippon Paper* holds that *Illinois Brick* does not preclude a damage claim by an entity purchasing from the trading companies at a price fixed by the conspirators. *See United States v. Nippon Paper Indus. Co.*, 109 F.3d 1, 2 (1st Cir. 1997) (trading houses agreed to sell at "specified prices") (cited by *Nippon Paper*, 281 F.3d at 631). As the majority below noted, Petitioners did not allege a resale price maintenance theory involving software products, or a horizontal conspiracy to fix the price of software or computers. Rather, they alleged that Microsoft, a monopolist, overcharged the OEMs and that the OEMs, in turn, passed on some or all of that overcharge to customers. Pet. App. 30a-31a. That is not the kind of antitrust theory involved in the trilogy of cases relied upon by Petitioners, and the Panel correctly distinguished that precedent.

B. The Judgment Is Consistent with this Court's *Illinois Brick* Precedent.

Illinois Brick is grounded in two principal rationales: (a) fear of multiple recovery if both direct and indirect purchasers are permitted to sue a manufacturer; and (b) price-tracing difficulties, particularly where a supplier's component is integrated into products by direct purchasers who then sell the system to end-users. As the Court below noted, both of those concerns are implicated in Petitioners' claims.

1. Petitioners Are Indirect Purchasers of Software.

Petitioners did not buy a Microsoft operating system or Microsoft applications programs from the Respondent OEMs. Rather, they purchased computer systems, which integrated a variety of components: monitors, keyboards, memory chips, processors, operating software, and applications software. The Respondent OEMs are, by Petitioners' own admission, part of a highly competitive industry with significant price competition. Pet. App. 17a-18a. If, as is alleged, Microsoft was able to extract anti-competitive higher prices from the OEMs, it is the OEMs as direct purchasers who have the authority to sue. *Illinois Brick,* 431 U.S. at 745-46. Petitioners, in turn, are only "indirect" purchasers of software from Microsoft and direct purchasers of computer systems from the OEMs. As in *Illinois Brick*, the component (brick) was integrated into a finished product (building). As in *Illinois Brick*, plaintiffs who purchase the final product are indirect purchasers of the component and are not entitled to sue.

Here, the named Respondent OEMs — Dell, PB, and Compaq — have thus far not elected to sue Microsoft,

although they are members of some of the proposed plaintiff classes. *Illinois Brick* recognized that direct purchasers such as the OEMs may refrain from bringing a treble damages suit but that, despite that fact, the antitrust laws were better served by limiting the right to sue to direct purchasers. 431 U.S. at 746. Petitioners offer no reason to deviate from this Court's long-standing rule.

2. There Are Overcharge Tracing Complexities.

As to the second factor, the Fourth Circuit concluded properly that if the Petitioners' case were to proceed, a trial court "would be required to determine the over-charge, if any, for Microsoft software that was passed on to consumers — the exact analysis that *Illinois Brick* forbids." Pet. App. 31a. Petitioners suggest that this analysis was somehow deficient. Pet. at 25-28. But in fact the decision tracks the rationale of this Court in *Illinois Brick,* where this Court recognized that "the attempt to trace the complex economic adjustments to a change in the cost of a particular factor of production would greatly complicate and reduce the effectiveness of already protracted treble-damages proceedings." 431 U.S. at 732.

In short, nothing in the Panel decision below warrants this Court's review of the *Illinois Brick* doctrine: there is no conflict among the courts of appeals and the decision is consistent with this Court's *Illinois Brick* analysis. In fact the Fourth Circuit should be commended for following this Court's admonition to refrain from carving out new exceptions to the *Illinois Brick* direct purchaser rule. *UtiliCorp*, 497 U.S. at 216.

CONCLUSION

The petition for a writ of certiorari should be denied.

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IN THE
Supreme Court of the United States

CAREY D. EBERT, AS TRUSTEE IN BANKRUPTCY FOR GRAVITY, INC., AND MARK H. DICKSON,
Petitioners,

v.

MICROSOFT CORPORATION, COMPAQ COMPUTER CORPORATION, DELL COMPUTER CORPORATION, AND PB ELECTRONICS, INC. (F/K/A PACKARD BELL NEC, INC.),
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Fourth Circuit

REPLY BRIEF FOR PETITIONERS

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REPLY BRIEF FOR PETITIONERS

The decision below creates multiple conflicts with decisions of this Court and other circuits on each of the three inter-related questions presented. The panel majority's unprecedented and dangerous legal standards effectively immunize a broad antitrust conspiracy between Microsoft and its three biggest distributors. The decision both "increases the likelihood of future anticompetitive conduct" and "creates a strong disincentive to innovate" for upstart software makers seeking to compete with Microsoft. Dissent, Pet. App. 45a. That result, if not corrected, will harm millions of consumers not only in this case and in the software industry, but in all future cases arising in the Fourth Circuit concerning any industry where a major supplier organizes a broad conspiracy with its major distributors to suppress the supplier's competition.

I. THE PANEL MAJORITY'S HUB-AND-SPOKE HOLDING CONFLICTS WITH PRECEDENT FROM THIS COURT AND OTHER CIRCUITS

Gravity alleged that each OEM defendant executed its anticompetitive agreement with Microsoft knowing that the scheme engineered by Microsoft was broader than any one agreement with a single OEM. Under standards set out by the Sixth and Eighth Circuits, such a hub-and-spoke conspiracy is actionable. *See* Pet. 12-14. Likewise, Gravity's hub-and-spoke allegations are fully in line with this Court's controlling antitrust conspiracy precedents. *See* Pet. 14-16; *United States v. Masonite Corp.*, 316 U.S. 265, 275 (1942); *Interstate Circuit, Inc. v. United States*, 306 U.S. 208, 227 (1939).

Strikingly, the OEM defendants – like the panel majority – completely ignore the latter two conflicts, which is powerful evidence that they are irreconcilable. *See Good News Club v. Milford Cent. Sch.*, 533 U.S. 98, 109 n.3 (2001) ("this oversight is particularly incredible because the [panel] majority's attention was directed to [a controlling precedent] at every turn"); Dissent, Pet. App. 34a-35a (faulting majority for not following *Masonite* and *Inter-*

state Circuit). Similarly, Respondents (again, like the panel majority) fail to address the irreconcilable conflict created by the panel's majority's turning a blind eye to *Blumenthal v. United States*, 332 U.S. 539, 558 (1947), when it declined to follow the Sixth and Eighth Circuit's hub-and-spoke decisions. *See* Pet. 14-15 & n.9.

Unable to defend (and utterly declining to address) the conflicts with *three* of this Court's decisions, the OEMs (at 17-18) next pretend there is no conflict with the Sixth or Eighth Circuit because Gravity's claims would fail in any case under their hub-and-spoke standard. But the panel majority obviously disagreed; otherwise, it would not have gone so far as to hold the standard itself unlawful. *See id.* at 10a-11a. Moreover, while running away from the panel majority's flawed reasoning, the OEMs fail to reveal that the district court's analysis on which they now rely was expressly rejected by the panel majority because it wrongly applied a heightened § 2 "specific intent" standard to Gravity's § 1 claims. *Compare id.* at 8a (explaining that the district court disregarded the controlling § 1 intent standards and "did not separately examine the sufficiency of Gravity's [§§ 1 and 2] claims") *with* OEM Br. 17 (relying on district court's specific intent requirement that the OEM defendants' "minds had met *to maintain Microsoft's monopolies*") (quoting Pet. App. 54a) (emphasis added, internal quotation marks omitted).[1] Indeed, the panel majority agreed that Gravity had satisfied the applicable § 1 "intent" requirements. *See* Pet. App. 13a.[2]

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[1] The OEMs had persuaded the district court that Gravity's §§ 1 and 2 claims "coalesced" into a § 2 claim, Pet. App. 48a-51a, but the panel majority correctly rejected that theory out of hand, *see id.* at 8a; Pet. 10 n.5. The OEMs did not even defend this novel coalescing theory in the court of appeals, so it is especially ironic for them to lug it out now.

[2] As the panel majority correctly explained, "the 'combination or conspiracy' element of a section 1 violation is not negated by the fact that one or more of the co-conspirators acted unwillingly, reluctantly, or only in response to coercion. . . . The co-conspirators need not share the same motive or goal; it is sufficient to allege that the co-

In a variant of this erroneous specific intent theme, the OEMs claim (at 18) that each "spoke" must have "had reason to know that its actions were unlawful." But the OEMs identify no legal requirement – and there is none – that they had to "know" in advance how their actions (of which they most certainly were aware) might be evaluated under the antitrust laws.[3] In any case, the OEMs surely knew their exclusionary agreements with Microsoft – which kept Microsoft's middleware competitors, including Netscape, from their computers – were anticompetitive and thus could well be illegal under the Sherman Act. As the dissent concluded, "[r]egardless of whether any OEM desired the participation of other OEMs (and they conceivably might have), Gravity alleges that each OEM joined a conspiracy which it knew was, by its nature, broader than just itself and Microsoft." Pet. App. 34a.[4]

II. THE DECISION FLATLY CONTRAVENES THIS COURT'S NOTICE PLEADING PRECEDENT

The decision below also conflicts irreconcilably with the Court's recent and unanimous notice pleading pronouncement. "[U]nder a notice pleading system, it is not appropriate to require a plaintiff to plead facts establishing a prima facie case." *Swierkiewicz v. Sorema N.A.*, 122 S. Ct. 992, 997 (2002). "This simplified notice pleading standard relies on liberal discovery rules and summary judgment motions to define disputed facts and issues and to dispose of unmeritorious claims." *Id.* at 998.

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conspirators acquiesced in an illegal scheme." Pet. App. 13a (citing numerous cases) (internal quotation marks and alteration omitted).

[3] Although "Congress has . . . softened the impact of the common-law presumption [that ignorance of the law is no defense to criminal prosecution] by making specific intent to violate the law an element of certain federal criminal tax offenses," *Cheek v. United States*, 498 U.S. 192, 200 (1991), the OEMs can identify no such alteration with regard to civil liability under § 1 of the Sherman Act.

[4] The OEMs suggest this pleading-stage case is an inappropriate vehicle for review, but the hub-and-spoke standard is purely a question of law and would benefit little if any by further factual development.

The panel majority disregarded the conspiracy's combined power in the relevant *software* markets, fabricating instead a requirement that Gravity plead the OEM defendants' *computer* market shares, thus failing to take the complaint as pled. *See id.* (authorizing dismissal "only if it is clear that no relief could be granted under any set of facts that could be proved consistent with the allegations") (internal quotation marks omitted). As explained further below, that requirement is wrong on its own terms. But, even if Gravity were required to meet that test at trial if relying on *circumstantial evidence* of anticompetitive effects in the relevant software markets, this "Court has made crystal clear ... that an evidentiary standard does not determine the adequacy of a complaint. It is inappropriate, therefore, to require plaintiffs to plead facts going to that evidentiary standard." Dissent, Pet. App. 36a (citation omitted); *see* Pet. 16-17.

Like the *McDonnell Douglas* test at issue in *Swierkiewicz*, the panel majority's market share requirement is a circumstantial *evidentiary* standard inapplicable at the pleading stage. A plaintiff need not "plead more facts than he may ultimately need to prove to succeed on the merits if direct evidence ... is discovered." *Swierkiewicz*, 122 S. Ct. at 997. "[D]irect evidence of anticompetitive effects" renders "'elaborate market analysis'" unnecessary. *Toys "R" Us, Inc. v. FTC*, 221 F.3d 928, 937 (7th Cir. 2002) (quoting *FTC v. Indiana. Fed'n of Dentists*, 476 U.S. 447, 461 (1986)) (finding defendant toy retailer with just 20% of U.S. retail market "was remarkably successful in causing the 10 major toy manufacturers to reduce output to ... warehouse clubs, [which] protected [defendant] from having to lower its prices to meet the clubs' price levels").

The OEMs (at 15) say only that "[d]iscovery certainly would not provide any" direct evidence, but that self-serving statement is at odds both with the very purpose of discovery and with *Swierkiewicz*. "Rule 8(a) establishes a pleading standard without regard to whether a claim will

succeed on the merits. Indeed it may appear on the face of the pleadings that a recovery is very remote and unlikely *but that is not the test.*" *Swierkiewicz*, 122 S. Ct. at 999 (emphasis added, internal quotation marks omitted). The panel majority's annihilation of *Swierkiewicz* in the Fourth Circuit could not be more plain.

Further, the record – even at the pleading stage, where evidence is not required – already contains evidence that the OEM defendants' conduct caused actual anticompetitive effects in the relevant software markets. Microsoft itself thought these OEMs essential to its scheme, for it lured them with incentives and special benefits that were denied other large OEMs, such as IBM and Gateway, that "resisted Microsoft's efforts to enlist them." *Microsoft*, 84 F. Supp. 2d at 27 (¶ 64). The OEMs (at 14) pretend they were mere innocent victims of a monopolist, but the unsealed evidence from the government's case (where the OEMs' conduct was not directly at issue) tells a far different story of their vying with Microsoft to police their competitors' adherence to common restrictions that, in short order, shut Netscape and other middleware out of the market.[5] That scheme was fantastically successful. *See* 84 F. Supp. 2d at 69 (¶ 239) ("By January 1998, . . . of the sixty OEM sub-channels . . . , Navigator was being shipped through only four.").

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[5] Compaq, for example, was using Netscape internally and candidly noted that its agreement with Microsoft "raises questions of improper use of a monopoly position." C.A. App. 385, 389, 422. In 1998, a senior PB product manager believed it would be "ideal" to give all its laptop customers the option of Netscape, *id.* at 437-39, yet PB apparently agreed to preserve the standard Windows desktop without Netscape in exchange for royalty benefits, *id.* at 391. Compaq and Dell went along, though they knew such restrictions harmed both customers and product quality. *Id.* at 385. Dell further expressed "concern" to Microsoft about how well PB was observing restrictions on modification of the Window's boot-up sequence and the desktop, and asked how "[Microsoft] intends to police the Windows Experience" under the OEM agreements. *Id.* at 448-51.

Although beside the point here because Gravity was not required to plead a circumstantial case, it bears noting that the OEMs (at 11-12) wrongly fault Gravity's reliance on the power of the *conspiracy* to raise price and reduce output in the relevant software markets. Under black-letter law, it is entirely proper to hold Microsoft's co-conspirators liable for actions that Microsoft took in furtherance of the conspiracy.[6] "[A]fter all, the reason for looking at market power is to determine whether the combination or conspiracy, not each individual conspirator, has the power to hurt competition in the relevant market." *Spectators' Communication Network Inc. v. Colonial Country Club*, 253 F.3d 215, 225 (5th Cir. 2001).

The OEMs defendants (at 11) characterize Gravity's claims as "breathtaking," but it is their own theory of antitrust immunity that is fatally out of step. Far from being no different from other OEMs, it was these frontline partners – Microsoft's biggest distributors – who led the charge by first agreeing to Microsoft's scheme to exclude middleware, in the process extracting special benefits and incentives from Microsoft. This critical mass made it possible for Microsoft to accomplish its exclusionary goals. Rather than use whatever bargaining leverage they had with Microsoft to negotiate *lawful* terms that would not exclude competition in the software markets, Compaq, Dell, and PB each chose instead to obtain discounts and non-price benefits that their rival software distributors were denied, giving these OEMs a relative competitive advantage vis-à-vis their competitors. That action was, at the very least, a "material cause" of the massive consumer harm at issue in this case. *Zenith Radio Corp. v. Ha-*

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[6] *See, e.g., United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150, 253-54 (1940) ("[S]ales by any one of the respondents . . . bound all. For a conspiracy is a partnership in crime; and an overt act of one partner may be the act of all without any new agreement specifically directed to that act.") (internal quotation marks omitted); *Salinas v. United States*, 522 U.S. 52, 64 (1997) ("so long as they share a common purpose, conspirators are liable for the acts of their co-conspirators").

zeltine Research, Inc., 395 U.S. 100, 114 n.9 (1969). Under *Swierkiewicz*, Gravity is entitled to proceed to discovery on its claims, and this Court should grant review to assure lower court adherence to that important precedent.

III. THE DECISION CONFLICTS WITH CIRCUIT PRECEDENT APPLYING *ILLINOIS BRICK* AND UNDERMINES *ILLINOIS BRICK* ITSELF

This Court based the indirect purchaser rule of *Illinois Brick Co. v. Illinois*, 431 U.S. 720 (1977), on the view that direct purchasers have more incentive than indirect purchasers to sue for an antitrust violation, thereby providing maximum antitrust deterrence. *See* Pet. 23-24. The decision below undermines this goal by giving the sole right to sue to a co-conspirator in that violation – thus providing about as much deterrence as would designating Enron executives the exclusive private attorneys general for enforcement of the securities laws. Denying co-conspirators the protection of *Illinois Brick*, on the other hand, "maximizes deterrence by giving the right to sue to the plaintiff with the most incentive to sue" – the direct purchaser from the conspiracy. Dissent, Pet. App. 43a.

As three circuits have held (and four others have suggested), this fundamental concern renders *Illinois Brick* and its progeny inapplicable to conspiracy claims, for those decisions "are themselves designed to improve deterrence." *Paper Sys., Inc. v. Nippon Paper Indus Co.*, 281 F.3d 629, 633 (7th Cir. 2002); *see* Pet. 21-22. Respondents completely ignore that deterrence rationale (because they have no answer for it) and instead claim that there is no conflict worthy of review because the circuit court decisions finding *Illinois Brick* inapplicable to conspiracies should be limited to the price-fixing context.

None of those decisions was so limited. Although Judge Easterbrook's opinion in *Paper Systems* noted, in reciting the facts, that the defendants had conspired "to reduce output and raise price," the court nowhere mentioned the term price-fixing or relied on any ease of determining damages, as Respondents' theory would have it. 281 F.3d

at 631. To the contrary, the court explained that, if "the amount of the overcharge . . . cannot be established . . . *by the conspirators' own agreement*[,] then it is necessary to determine the elasticities of supply and demand. But this prospect is present in every cartel case; it is not occasioned solely by the presence of intermediaries." *Id.* at 633 (emphasis added). Likewise, *Fontana Aviation, Inc. v. Cessna Aircraft Co.*, 617 F.2d 478, 481 (7th Cir. 1980), held *Illinois Brick* inapplicable to a multifaceted conspiracy not limited to pricing. Microsoft claims (at 6 n.1) that *Fontana* was decided solely on the basis of the plaintiff's competitor status, but that was simply "another reason" that the case did not "fit within the *Illinois Brick* mold." 617 F.2d at 481.[7] The Seventh Circuit has repeatedly relied on *Fontana* (its own precedent) as primary authority for holding *Illinois Brick* inapplicable to conspiracies, which would be impossible if Microsoft's reading were correct. *See Paper Sys.*, 281 F.3d at 632; *In re Brand Name Prescription Drugs Antitrust Litig.*, 123 F.3d 599, 604 (7th Cir. 1997) (Posner, J.). These conflicts are patent and amply warrant this Court's review.

Respondents also wrongly portray *Kansas v. UtiliCorp United, Inc.*, 497 U.S. 199 (1990), as suggesting that the indirect purchaser rule applies to all conspiracy claims (including those alleging price-fixing). Microsoft Br. 5-6; OEM Br. 21, 24. But no conspiracy claim was raised or even mentioned in *UtiliCorp* (or in any of the Court's *Illinois Brick* line of cases), and *UtiliCorp* actually supports Gravity's position here. In declining to carve out an indirect purchaser exception for consumers of public utilities, Justice Kennedy wrote for the Court that it might have held otherwise "[i]f we were convinced that indirect suits would secure [the vigorous enforcement of the antitrust laws] better in cases involving utilities." *UtiliCorp*, 497 U.S. at 214 (finding adequate incentive for utilities to sue to recover overcharges by their energy suppliers).

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[7] Microsoft's court of appeals brief (at 22 n.11) recognized that, in *Fontana*, "plaintiff was both a customer and a competitor."

Respondents can offer no reason why "the vigorous enforcement of the antitrust laws" (*id.*) is best entrusted exclusively to a co-conspirator, and there plainly is none. When this Court addressed coordination among firms in *Illinois Brick*, it expressly recognized control and cost-plus contract exceptions that are applicable because "market forces have been superseded." 431 U.S. at 736 n.16. That is precisely the case here, where the conspiracy "circumvent[ed]" normal "complex market interactions" between Microsoft and the OEM defendants. *Id.* at 736. Holding an antitrust conspiracy outside *Illinois Brick* is thus "compatible with *Hanover Shoe*, *Illinois Brick*, and *Utili-Corp*." *Paper Sys.*, 281 F.3d at 632-33. The panel majority's complete undermining of *Illinois Brick*'s foundation is yet another reason to grant review.[8]

Given the utter lack of deterrent value from placing the sole private antitrust enforcement right in a co-conspirator, the price-tracing and double-recovery concerns are simply inapplicable. *See id.* at 632 ("The right to sue middlemen that joined the conspiracy is sometimes referred to as a co-conspirator 'exception' to *Illinois Brick*, but it would be better to recognize that *Hanover Shoe* and *Illinois Brick* allocate to the first non-conspirator in the distribution chain the right to collect 100% of the damages."); *Brand Name Drugs*, 123 F.3d at 604 ("[A]ny indirect-purchaser defense would go by the board, since [plaintiffs] would then be direct purchasers from the conspirators."). In any event, neither concern applies here.

The OEM defendants (at 24) merely repeat the panel majority's unreasoned conclusion that *Illinois Brick*'s price-tracing concern is present, and Microsoft declines to join issue. But the sole point of that concern is to avoid having to allocate damages between the direct and in-

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[8] *See Copperweld Corp. v. Independence Tube Corp.*, 467 U.S. 752, 768-69 (1984) ("Congress treated concerted behavior more strictly than unilateral behavior [because it] . . . deprives the marketplace of the independent centers of decisionmaking that competition assumes and demands.").

direct purchasers. In a conspiracy, however, there can be no such allocation because the conspirators are jointly and severally liable for all the damages they have caused and may not seek contribution from each other. *See* Pet. 25-26. There simply is no pass-on that needs to be determined. *See* Pet. 26-27. Respondents' failure even to attempt rebuttal of these arguments is further proof that the panel majority's decision is indefensible. *See* Dissent, Pet. App. 43a ("How much of its monopoly profits Microsoft retained is merely a matter of how the conspirators allocated the fruits of their alleged illegality, and is not directly relevant to Gravity.").

Microsoft (at 7) attempts to invoke the double-recovery concern because the OEM defendants, when Microsoft filed its brief, were members of some proposed classes before the district court. Since then, however, the district court has denied class certification, in large part because such "business customers . . . , through their own inaction, have evidenced a disinterest in their potential claims." *In re Microsoft Corp. Antitrust Litig.*, No. MDL 1332, 2003 WL 1878759, at *5 (D. Md. Apr. 14, 2003). That finding accords fully with the OEM defendants' statement here (at 23-24) that they "have thus far not elected to sue Microsoft."[9] That refusal to sue is part of the conspiracy. The Court should not allow Respondents to turn it into an antitrust liability shield. *See Freeman v. San Diego Ass'n of Realtors*, 322 F.3d 1133, 1145-46 (9th Cir. 2003) ("indirect purchasers can sue for damages if there is no realistic possibility that the direct purchaser will sue its supplier over the antitrust violation" by virtue of its co-conspirator status) (Kozinski, J.).

CONCLUSION

For the reasons stated above and in the petition for a writ of certiorari, the petition should be granted.

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[9] Early in this case, counsel for Compaq candidly suggested that any class certification would cause the OEM defendants to "opt out and decide not to pursue any claims against Microsoft." C.A. App. 165-66.

Respectfully submitted,

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